John Jardim:

Hello, everyone. Just, just wait another, sort of, few minutes or so, just to make sure everyone's dialing in before we start. Numbers are increasing, which is good.

Alright, maybe we'll, maybe we'll make a start as the numbers start to increase. So, hello everyone, and welcome to Pzena Investment Management's Global Outlook for Value webinar.

Today's discussion is titled, *Finding Value in a Momentum-Driven Market*.

Momentum has been a defining force across global equity markets, and in many places, it's become the dominant driver of returns. That's raised real questions about cycles, discipline, and, you know, where value investors fit today.

So, in this session today, we're going to focus on three things. The outlook for value investing as we head into 2026, what history tells us about momentum-driven cycles, just to provide a bit of context and then, more importantly, how we're positioning our portfolios, given today's opportunity set.

So what we'll do is we'll break it up into two parts. We'll start with a discussion, and then open up the audience to a bit of Q&A. We have some questions come through on a lot of people registering, so we've got some good questions already, and we'll probably see some additional questions come through as we're going through.

So, just some formal introductions, my name is John Jardim, and I'll be moderating today's session, and I'm joined today by John Goetz and Dan Babkes.

John is a regular to our part of the world, so a very familiar name to most. He's our co-CIO and portfolio manager, and he co-manages our global, international, European, and Japan-focused value strategies. John is a founder and joined Pzena in 1996, and previously served as the director of research, so he's seen many cycles and many versions of momentum.

Dan is the new kid on the block. Well, when I say new kid on the block, Dan joined the firm in 2016, so it's really his 10-year, 10-year anniversary this year. Dan is a portfolio manager and co-manager on our focused value and large cap strategies. But importantly, was recently added to the global team as a co-portfolio manager.

So, Dan, congratulations on joining John and the global team.

Daniel Babkes:

Thank you.

John Jardim:

Excellent. So, let's... let's set the scene a little bit and talk about where we find the market backdrop.

So, momentum, as I mentioned before, you know, it's been a dominant return across developed markets last year in both the US and non-US developed markets, momentum stocks have outperformed roughly by 20%, and in the US, this is now the second consecutive year where momentum has been the leadership of returns. So, the key question isn't what has worked, it's really what are the other parts of the market? What's being left behind? What opportunities are being created for value investors as we head into 2026?

So, John, starting globally, maybe just to provide some context, let's answer this question. You know, what's the most important way this momentum cycle compares to prior ones, and what's meaningfully different this time around?

John Goetz:

Yeah. Well, the similarities... so last year, and if you haven't read our newsletter, we wrote about it in the newsletter, last year, 2025, will go down as... as up there in the 90th plus percentile of momentum markets. And when you think about what does that mean, it means that a stock price going in a certain direction, continues in that direction, and gets accentuated. I like to say we've seen a lot of, over the last two years, a lot of quarterly earnings where the earnings are down by 2%, the stock's down by 10%. Or earnings are up by 5%, the stock's up by 10%.

You know, just intuitively, you can see that the market is projecting the recent bias and the recent effects. Whenever we've had that, like, if you think about way back to dot-com, which was the first momentum cycle we faced at Bazina now, almost 30 years ago, the similarity with this one is that there's a lot of hope in the market. You know, we... you know, I travel all over the world looking at companies and meeting clients, and we talked about the Magnificent Seven.

But it's kind of morphed into the hope of AI transformation, and the hope of AI being a massive game changer is now at very high levels. And that's similar. There's always a major hope, I'll say, a major positive behind these momentum cycles. The other thing that's very, very similar to prior cycles is that it drives dispersion. So, the hads and have-nots, the loved and the unloved, Why now?

So that's also very similar to the prior extreme momentum cycles that we've seen. You know, I like to say at any given time, there's both hope and despair in the market, and we're going to talk about that, because clearly our hunting ground is where fear has created opportunity.

Now, what's different this time is that some of the aspects of what has momentum and how momentum is working is a little bit nuanced. Dan will talk a little bit more about that nuance, you know, in the U.S.

But the nuance here, in the globe, when I look at it, is if you look at it, financials, particularly in Europe and Japan, actually were part of the momentum part of the really strong, stock price movements in a single direction. So we actually had value sector, financials, participate, in the momentum this time. So it's kind of interesting. Now, just to give you the high level, we use those types of periods to lighten up where there is momentum, like financials, capture some of those profits, and then find the newly unloved, I call it. So, it is a little bit nuanced this time, and that's why value, as a style outside the United States, actually worked last year. So it's very interesting and different. If you remember all the way back to .com, those of you that were participating in that cycle, you might remember that from SoftBank in Japan to a company like Ericsson in Europe, to the U.S, TMT, that... that was all... it was kind of a global sector-driven thing, and the differences between the regions weren't as pronounced as they were this... this last cycle. So... so the momentum this time is... is more firmly concentrated in the U.S. around the AI hype.

John Jardim:

Well, let's bring Dan into the conversation, and so, early in the cycle, leadership felt concentrated in mega-cap growth names, and as John mentioned already, the sort of MAG7 and MAG10 became part of our vernacular. But more recently, it's broadened in a way that feels a bit more speculative.

So the question then is, what's changed? Why does it matter for investors, Dan?

Daniel Babkes:

Yeah, I think that's an astute observation. I think there's definitely been some signs of real speculative behavior as the momentum cycle has continued.

And, you know, you've really seen that in a few different ways in the U.S. markets. There have been some examples, like meme stocks that have had, you know, kind of outrageous outperformance at times, or the outperformance of unprofitable and high short interest type businesses. I think those are all some anecdotal signs of the speculative behavior that you're referring to. But really, what I think the most interesting observation about what's going on in the market, and John already referenced this, but it's really the dispersion. So, what I think is exciting about this environment for our style of investing is there's dispersion within the market

And that's in part driven by the momentum dynamic that we're describing. So, the loved stocks are really loved, the unloved stocks are really unloved, but there's a kind of double effect that we're seeing right now, which is there isn't this coordinated positive tailwind across industries broadly that we're seeing in the U.S. So you would be mistaken, if you just looked at the market averages, you would say, well, everything must be rosy across a very wide range of industries in the U.S, and that's actually really not true.

So we're seeing, some real signs of... of growth from industries that are directly benefiting from the AI hype, so...

So, you know, some examples of that are, you know, the tech companies that are benefiting directly, some suppliers, into the build-out of data centers, for example. They're seeing giant growth in their businesses. You know, capital formation is helping some financial institutions. And then you're seeing a lot of industries that are in serious pain.

And some of that is related to, excess supply that had been accumulated coming out of... out of the pandemic, or they're... they're dealing with sluggishness because of the technology change and some uncertainty that that's created in the market. So you're seeing the divergence in the underlying fundamentals of businesses, and then the market creating bigger dispersion on top of that, so the opportunity set is just... is really lumpy and attractive for us. And then the one other piece I would add to that is we always find company-specific opportunities, aside from just... just... just the variances in industry. And right now, and you can just kind of see this in valuation multiples we're seeing a lot of different opportunities, and you're really getting paid to play the dispersion traits. So it's a pretty exciting environment for what we do. And you wouldn't think that, just given how expensive broad market averages are and what's going on in the world, that it's such a target-rich environment for us, but it really has been.

John Jardim:

Thank you. Look, I think your points are... you really need to peel the onion back around this market, because the dispersion is a real thing. So, let's maybe look ahead. When we look forward to 2026, you know, the starting point really could be, you know, what matters most for value investors right now.

So, John, maybe I'll start with you from a global perspective. You know, what should value investors be aware of? What should they be thinking about?

John Goetz:

Well, I think that you have to be ready for the turn, the next phase. You know, we never really know when the momentum phase ends.

But I like to say, John, I like to say that we don't want to be amateurs in a professional game, if you think about momentum as quant and something that we're not trying to apply. So we're always looking for shifting our portfolios away from something that's worked into something that's, inexpensive. It requires pain.

Right? That's what Dan was saying as well. What's interesting, I'll just make a comment about outside the United States first, and then then, you know, I'll let Dan talk about the U.S. again. But, you know, lots of points of pain when you think about what's going on exogenously, including, you know, still trade, tariff issues, you know, the invasion of GLP-1 into the... GLP-1s into the health space, AI we talked about, the auto transition is still going on to EVs and China's ascendancy, Europe figures are still there. We just have another emerging market collapsing, Indonesia. So, so, you know, there's just a lot. I'll just say, of things going on in the environment. And what we have to do is be fleet of foot to examine the new crisis, and the company's caught up, you know, in the new crisis.

John Jardim:

Yeah, no, a lot of things that you've raised, you know, happened really quickly as well, so a lot of multiple things happening at the same time.

Maybe, Dan, just to bring it back to the US, you know, and probably the question we get, or the comment we get asked a lot is. You know, some investors would probably argue that structurally value has changed, and that, importantly, like, benchmarks and the composition of benchmarks makes it harder for managers to compete. What's your view around that idea of, sort of, structural change versus, you know, value?

Daniel Babkes:

Yeah, so I think there's really two parts embedded in that question. So one is a fundamental question. So is something fundamentally changed that, you know, value investing won't work the same way that it has historically?

You know, frankly, I don't even think that premise makes sense. And the reason I say that is if you think about what we're doing on a fundamental basis. It's we're trying to take advantage of fear that's in the market. Now, that could be either real fear, like the earnings have gone down for a company, or fear that they will go down for this company in the future because of some kind of change that's coming. So, we're trying to take advantage of that. And underpay structurally for a long-term stream of cash flows.

If you can do that intelligently and with a reasonable hit rate, so you are structurally underpaying for cash flows that actually come through, mathematically, you have to generate a reasonable return. That's just... that's not... that's not something that can, you know, structurally change. What can structurally change is, you know, are accounting conventions that people use as shortcuts to implement value investing, do they become less accurate ways of implementing the strategy?

I don't know that I've seen any data that really shows that that's even true, but that's possible. It's possible that it's harder to do a naive price-to-book screen to get real exposure to value investing, or a naive price-earning screen to get exposure to value investing.

Because, you know, companies are, you know, less asset-heavy than in current times than they used to be historically. I don't know if I really believe that, but that's theoretically possible. The good news is that's never been the way that we've invested. We're always looking fundamentally to understand the long-term cash flow potential of the business.

And that just can't really shift, right? And even some of the arguments you've made around these business models changing over time, it's really starting to go the other way. Like, a lot of the big tech companies that would have been the poster children for businesses that are not asset-heavy, that grow their cash flow, they're now starting to make some of the largest investments we've ever seen in the history of Earth in data centers, so they're starting to become asset-heavy, right? So I would really take the other side of that argument. The second point in your question is around index composition.

And this excitement that people have around... around one market theme has changed the composition of the index. I would argue that's a really good thing for value investors from here.

Because the main thing that this has impacted, it hasn't impacted the actual cash flow potential of businesses and the fundamental realities that we're betting on. What it has changed is the multiples that people pay for things that they're excited about. So, what's happened, effectively, is the momentum-driven part of the market has gotten so expensive and become such a big part of the market that it's even started to pollute the style indices now.

So the, the... yeah, I love to give this statistic. The Russell 1000 Value Index currently has 870 stocks in it, which, you know, as a value investor, that's like a preposterous thing, to think that there's 870 stocks out of 1,000 that are value stocks, it doesn't even make sense. And then if you look at the valuations I think the index is trading at 19 times forward earnings, so what's exciting about that from our perspective, and why I would argue it's in the future, going to be maybe easier for a thoughtful value investor to compete.

In our portfolio, we have, in the U.S, in our large-cap portfolio, we'll have a concentrated portfolio of 30 to 40 stocks, trades at 11 times forward earnings. Which I think is going to have a very different outcome than an 870 stock index that trades a 19x earnings. It's a much, it's a much better starting point. So it has really impacted the index construction, but I think from here, that's a very good thing for an active value investor, actually.

John Jardim:

Thanks, thanks for that, Dan. Maybe one last piece of context before we turn to the portfolios. A recurring question we get is whether it's whether momentum and value are fundamentally opposed to each other, or whether they are simply different and operate in different time horizons. So, maybe, John, the questions for you is, historically, when does momentum become the most challenging for value investors?

John Goetz:

Yeah, yeah. Well, right... I mean, typically, weirdly, it's right at the end, right? Like, the second derivative of the multiple, just referring to multiples, as Dan was talking about, of that hope cycle, that excess, actually, it has a decent second derivative, then it gets noisy and then it falls apart. Okay, that's... that's the typical way that these things... by noisy, I mean, all of a sudden, Meta's going down while Google's going up, and then Meta goes back up, and, you know, like, it's getting noisy. The AI, who's the winner of AI, is getting noisy now, and the multiples are elevated.

So... so what... what happens then is when it comes apart. We don't... and I'm not forecasting that 2026 is when we're going to make a ton of money and... and look really smart, like we did after .com, but... but I... I'm... what I want to phrase for your... for the audience here is the fact that our job is to find these undervalued, but very well-positioned businesses. And when you do that, what you see in the history, in the data and it's a little bit different outside the United States than inside the United States, but the common frame is the next 5 years are very good for devalue.

So if you look at it, right at the end, the valuations, that's what Dan was referring to, even in the value index, the multiple you're paying for your hope is elevated, and then that makes a tough headwind for the next 5 years. I also want to point out that when the fundamentals turn, you know, when AI finally stops growing at 40% a year, in terms of the data center build, when that rolls over, then these companies have a hard time

Right? And that's what's going on even, you know, for companies like Meta, is that whether you're meeting the hype or not becomes the challenge. And I'll just point out that of the 10 stocks that were at the top of the market cap and the top of the hope in 1999, before .com, of those 10 largest companies caught up in that, we ended up buying 9 of them over the next 20 years. So there is the opposite side of that upward momentum and high expectations, which is then you stop meeting expectations, and then the market just takes you to the woodshed. So that's... it's at that turn that the next 5 years set up well for a value style.

John Jardim:

And Dan, maybe I'll loop you in here from a US perspective, and the question really for you is, in prior high-momentum regimes, you know, what tends to happen once these expectations peak?

Daniel Babkes:

Yeah, and it's... the data in the U.S. is, you know, pretty clear-cut, so we ran this analysis where we looked at different momentum regimes across a very long history. So, we defined high momentum as the top one-third of the observations.

And in that... in that year that John described, that... that the last year of the positive momentum regime, value tends to underperform. So I think on average, it's close to 3% behind in, in, in that moment. And then over the next 5 years, it outperforms by something like 7%, per year on average. So there's a... historically, there's been a huge, you know, pent-up outperformance that you realize in the five years after the momentum regime winds down. And going back to John's earlier point around, you know, it's very hard to call the timing of these things, and when things are gonna are going to start to adopt, but I do think it's instructive to kind of look at where the valuations are relative to history. And I happened to look at this this week, so I'll just share this, because I thought it was fascinating.

So I looked at, you know, our portfolio that, the focus value portfolio, which has been running since the inception of the firm, and the forward PE multiple for that portfolio today, is about the same as it was in Q4 of 1999, trades at about 11 times earnings, so there's been... been no real change in the multiples, that... that portfolio is paying since... since 1999.

At that time, so that was, you know, peak of the tech bubble type timeframe, the broad market, the S&P, was trading at 25 times earnings. Today, the Russell 1000, so I looked at it as the proxy for the broad market. It's trading a little over 24 times earnings. So, you've gotten to a point where the disparity has reached that, that, you know, kind of peak of the prior bubble-type levels.

And as John pointed out, you are starting to see some, you know, noisiness in the concentrated market leaders, so it's just, you know, who knows if that's predictive of anything, you know, we certainly don't. And the way we think about it is, if you underpay for the long-term cash flows, you're gonna get a good return in the long run, so that's what we're focused on, and try to block out the noise, but I do think it's interesting to note the the starting point on the valuations.

John Jardim:

Yep, no, thank you. And look, for those who haven't seen our quarterly newsletter, on our website, if you have a look at some of the thought leadership, we have, we have a piece there on the fourth quarter commentary of 2025, which goes into that in a bit more detail.

But, maybe let's move on to making this a little bit more concrete, and let's look at the portfolio implications. And this is where we really see dispersion really showing up.

And where we've spent most of our time as investors. So... so, John--globally, probably outside of the US. Over the last 5 years, we've seen our, sort of, global international holding shift meaningfully from, you know, financials and materials towards healthcare, IT, and consumer staples, which is not really the traditional bedfellow for value. So what's driven that shift? Is it mainly where opportunities exist today, or are fundamentals generally improving, or is it just the markets mispriced that risk?

John Goetz:

Yeah, well, I think as Dan alluded to earlier as well, the market has a hard time resisting the actual underlying business momentum.

Right? So, one of the things that drives the momentum in stock prices is the business momentum is good.

And when you think back to what we had as true crisis valuations back all the way to the GFC, which was primarily massive crisis in financials globally.

Australia kind of got left out of that in Canada, too, but... but Europe and the United States went right down into the sewer, right? Like, it was really dramatic. And then when you think about COVID, COVID hit financials again because places like Japan, we went into negative interest rate policy.

So if you think about, you know, a lending versus borrowing spread, right, it was almost impossible to keep it above zero.

So, you know, the reality is the hard... the financial sector got hit with... with the blows of GFC and then COVID. Energy had a negative futures price

In April of 2020. Oil was a negative price futures. I just repeat that to people because when it happened, it's just kind of unbelievable. You know, so, you know, the reality is energy was very hard hit. So when you think about a firm like us that has a disciplined screening tool that says, where are the stock prices the most interesting, most undervalued relative to what the earnings power of these businesses are, you know, financials, energy, you know, a lot of commodities appeared in the darkness of COVID. Some industrials as well. There were industrials that... I remember a couple of late-night calls with Dan, you know, talking to industrial companies that assumed their cash flow is going to be negative for the next, you know, year. Negative cash flow, not... not positive.

So, you know, the reality is that these crises created these opportunities, what I'll call, you know, in very specific places. That's what's amazing about this last year. The fact that financials have been working, we've been able to monetize that, it's spreading out into more what I'll call idiosyncratic situations. That's a combination of... of the exogenous environment not being great, like for staples, even, and, you know, whether I talk about staples in the food sector, or staples in the alcohol sector, right, or staples and used to be steady businesses in the healthcare sector, right? Those controversies are in these sectors now.

And those things have gotten pushed into the first quintile, and those are the projects that then we get to work on. I don't know if we... if, John, if you want to switch over to Dan, you know, to get the U.S. perspective on that, or you want me to give some concrete company examples right now, I'm happy to jump into that.

John Jardim:

Maybe, let's jump into maybe one stock example to sort of flesh that a little bit more, and then I'll get Dan in to talk about the US perspective.

John Goetz:

Yeah, yeah, okay. Well, you know, if we can find something that has both an exogenous pain point and a... I'll call it self-inflicted wound, or a very company-specific reason that the current optics of the financials look poor, I'm gonna pick Daikin, which

If you think about Japanese stock market, we know the Japanese stock market has actually been incredibly strong, over the last couple years. So when I say Daikin, which is an HVAC company, air conditioning, heating company, and a global leader in technology, particularly in the inverter technology and compression.

That, that, you know, when I say, well what could... what's wrong with that? Let's step back and realize that the China housing market collapsed.

Right? Over the last 5 years, and it's still bumping along the bottoms. The U.S, when interest rates ran up.

That went into, you know, a massive slowdown in building and Europe is still kind of caught in its, you know, Europe malaise in fear that the industrial fabric of Europe is coming apart at the scenes. So the reality is, if you think about units of air conditioning, both replacement and on the commercial side, that amount of spending has been soft when you stand back and look at that globally.

But more important than that is... those of you in Australia are more familiar with Daikin. Europeans are as well, because that mini-split technology, the Japanese were always leaders in that, and so their technology is available and well-known. In the United States. It's dominated by train and carrier, and that's mostly because the replacement market tends to lock on to one brand or the other, especially in the homeowner space.

So what's interesting about the United States is they decided, we're leaders in other parts of the world, why shouldn't we dominate, not dominate, but, you know, have this great business in the United States? Well, two impediments. One is you need a fabric of distributors and installers. Right, that want to work with your stuff.

So what they did was they acquired a weak player, which is Goodman, which is Texas-based, and they said, okay, we have to completely transform this. Technology, everything. And they rebuilt the plants, they... they vertical... they... they built back into the vertical integration like they have in Japan, which is a huge investment

On top of that, they jumped ahead. We have a regulation change in the U.S. As of January this year, the month we're in, we have to switch the refrigerant to a more environmentally friendly refrigerant. They took care of that, so they were already ready to do that last year, but the installers didn't want the new refrigerant.

Yeah. Because they just want to do what's easy and what they did last year. So the reality is, they were ahead and actually lost some sales because of that. So here's two self-inflicted wounds, a big investment cycle, and jumping out ahead in refrigerant, along with the exogenous.

It's made a high-return company and business look like a low return on capital business. You ran up the capital, and your return hasn't shown up. We expect the earnings of this company, now coming back to fundamentals, do we want to buy declining businesses that are in permanent decline? No.

We want to buy a well-positioned company whose earnings in the future are better than they are today. So, you know, according to our math, the earnings 5 years from now will be double what they are today for Daikin, you know, once they get through this period of hardship. So that's... that's just a concrete example. I say that to you on this... on this call, and I'm like, well, why is Daikin week? You know, today, and it's just a combination of things that we have to dig into and say, hey, these are temporary problems, they're not permanent problems. In these big transitions, including EV for autos, we have to be very careful not to buy into permanent problems. So I just want to make that... that emphasis there. So that's just one example of, we think, a really well-positioned company longer term, that the optics look bad right now.

John Jardim:

Yeah, thanks, John. I think, yeah, there's a lot of people on this call that will know the brand, Dakin. It's a... it's a quality brand, and it just shows that, you know, we are looking to buy good stock. So... so maybe shifting back to Dan, just in terms of a US context, or the sort of domestic, equities,

You know, we've seen the portfolio shift a little bit more over the last 5 years in our US holdings, moving from financials, industrials, and energy, as sort of John alluded to earlier to... towards healthcare and consumer staples. So maybe just in terms of context, what's driven that shift, and how much of that is being bottom-up stock selection, versus a reflection of where value has been most available?

Daniel Babkes: Yeah, well, you know, I would make the argument that it's all been bottom-up stock selection, and, you know, really... and you already referenced this, but the big shift in the portfolio, if I went back, you know, 5 years ago, there were a lot of cyclicals that were still in the portfolio. You could think about where we were in the economy at that moment of time, that you could say maybe that would have made sense that those were some of what you were seeing screening up from a bottom-up perspective.

And then today, you know, we've really made this big, this big rotation into healthcare, and there's nothing thematic about it, and I'll, you know, it might be helpful to go through some examples.

It's really bottom-up, theses that we're finding on companies that have a company-specific issue.

So, you know, there's some... there's some what I would describe as more top-down, you know, sort of thematic fears out there around the healthcare sector.

And that's not really what we do. You know, we don't think we have a better way of understanding what, you know, government budget pressures are going to be in several years, and what that's going to mean for reimbursement rates. That's not the way that we're investing or trying to make an assumption around price controls that may or may not impact certain, you know, specific drugs in the U.S. Like, we're not making those types of thematic investments.

What we're doing is we're digging into specific business models where we can identify a potential issue that's caused evaluation dislocation, and really trying to understand that. So, you know, one example that we've... that's become one of our larger holdings in the U.S. over the past few years is Baxter.

Now, and this is, I think, a good example of, you know, a stock that's really been left behind in this momentum regime, right? So... so Baxter is... you know, very high return. I kind of refer to it as, like, the staples of the healthcare equipment industry. So they manufacture a lot of the basic goods that hospitals would need to run their facilities. So think about IV fluid bags, pumps, beds, these, these types of general consumables.

And what happened to Baxter originally was they really got hit during the inflationary regime. So, they sold a lot of their products on fixed-price contracts multiple years out into the future.

And when their cost of goods started to inflate coming out of the pandemic, all of a sudden they found a lot of those contracts were upside down, and they started to experience a lot of margin pressure.

So that became the original opportunity that we saw in Baxter, was really well-positioned company with good market share in these core, stable products.

But a margin structure that had really collapsed from a pretty high level, down to, you know, down to somewhere that was, frankly, still okay, but, but they experienced a lot, they've experienced declining earnings just because of this, this contracting issue.

So we initiated our position in Baxter, and, you know, Murphy's Law, after we made the investment, a couple of other discrete items have gone wrong. So, the first one was they experienced a hurricane in the facility that makes 70% of the IV fluids that are distributed in the United States. They had a major supply disruption because of weather.

And, you know, that impacted their earnings stream, it impacted their cash flow, because they had to stock working capital, and their customers started conserving the IV fluids that they had, so it impacted demand. So that was one headwind and then, on the tail end of that starting to resolve, they had a ship hold on a new pump that they had just introduced to the market that was supposed to drive growth.

So what happened to Baxter was the stock price declined way more than the earnings contribution from the IV fluids or the pump. Actually, we think the response to the pump ship hold was more than the total lifetime value that that pump was ever going to contribute to Baxter, as far as the stock price decline.

So, putting all this together, you had a company that, a few years ago, before it experienced this margin pressure, used to trade at 25 times earnings because people thought it's this good, growing, stable healthcare business.

They've experienced this series of what we think are discrete temporary issues. The earnings have gone down, but we think from here, it's gonna be the same boring, stable, growing healthcare business that people used to think it was a few years ago, except the multiple went from 25 to sub-9 times earnings on an earnings number that's depressed. So we think the expected return from here in that stock is absolutely fantastic. And it's, it's pretty clear that, that, you know, weather disruption, temporary product, ship, shiphold problem, these are not structural, long-term things, these are, these are discrete items. So, so we're pretty excited about that one.

John Jardim: Excellent. All right, well, maybe just before we move on to questions, maybe let's take some key takeaways. And then let me briefly summarize a couple of points. So momentum has been extreme, but not uniform across regions. That's one comment we'll make.

John Jardim: The US has shown more speculative characteristics than non-US markets. And historically, extreme momentum periods often creates attractive long-term setups for value, which we've seen.

And then today, dispersion is creating opportunities for disciplined, fundamentally driven investors, and dispersion is really the key term there.

So, so with that, let's turn our attention maybe to some of the questions, and we've had some additional questions come through, so let me just quickly go through this.

If we don't get to all the questions, because we've had a few come through, or they fall outside of the scope of the conversation, we'll endeavour to get back to you and reach out to you directly. So, we will get to you if we don't address them on this call.

So maybe let's just start with… Sean, I might get you to answer this one, which is a… it's a… it's a good one. We've covered off a bit about Europe, but more generally, what regions currently do we see as more attractive for value stocks than other regions?

John Goetz:

Yeah, you know, before the start of 2025, you know, because we meet companies before we invest, I was joking with some investors with us that every management team I met in Europe was clinically depressed. And that was because, you know, a combination of the tremendous run-up in energy costs, and the, you know, weak economy, and then the tariff fear, etc. You know, it was just such a tough environment. Now, Europe has popped up, right, relative to U.S. valuations.

But what I'll say is, again, it's the left-behinds that we're looking for, not the ones that have rocketed up. So, to Dan's point, you know, we're still buying cheaply in Europe, because that Europe rise was concentrated.

Right? In a few sectors that had momentum. Again, you know, we're not saying that we don't want momentum in our stocks. Clearly, we owned a bunch of European financials, and we're monetizing that, so we need momentum.

Right? In the things we own at some point. But then once that takes place, that's when we have to move you know, to the other sectors. So I think there are still really good opportunities in Europe. Interestingly, when you look back even to the China weakness, you know, that coming out of COVID, and a lot of controversy over China on tariffs today.

I would say that, interestingly, you know, we still find opportunities in China, Europe and Japan, I just mentioned Daikin, so even though these markets have been strong recently, it's always finding the left behinds.

That… that really attract our attention. And then we just look at the absolute… the point Dan was making. We look at, kind of, what is the absolute price? That we're paying for the future cash flow of this business. And we want that to be low. It's a little bit like a private equity investor is thinking. We're looking at expected return by the cash of the business.

John Jardim:

Yeah, no, thank you. Look, we've got a couple of questions here on the same topic, so maybe if I… Dan, you covered the, sort of, index issue. But these questions around the global equities concentration. So more, how concerning is this global equities concentration risk? And is that evolving?

Daniel Babkes:

Yeah, so I guess my answer to that would be, how concerning is it? Well, it depends on how you're positioned.

And what I would say is, if you're in passive indices, I think it's quite concerning, frankly, because... and, you know, you can measure this a bunch of different ways, but if you look at the U.S. index, you could say the small handful of stocks that have been the market leaders, what percentage are they of the index? And, you know, we're at, you know, multi-year records, so that's a little bit concerning. You think you're maybe buying a diversified basket of stocks that's representative of a broad exposure, and it's not. You're taking some real concentration risk to, you know, one theme.

That's within the U.S. That's, I think, carried over into the global indices, so I think you could see that by what's the concentration of the U.S. exposure in global indices. It's all driven by that same theme, so...

So, you know, by being passive, you're not getting diversification, you're kind of getting concentration to the thing that everybody's already excited about and paying up for.

History says that's not a great place to be. Well, usually once there's already a lot of excitement, the things that cause the concentration tend to underperform in the future. So, so I think that's... I think that's concerning. What I... what I would say is, let me bring that back to our portfolio.

I don't think that's concerning at all, because our portfolios feel very normal to us, in terms of what we're buying. It's company-specific issues or industry gyrations that have caused the dislocations that allow us to buy stuff cheap, and they feel like the normal types of things that we've invested in historically. The valuations look really attractive. It's a target-rich envi... so it's, it's, you know, it's concerning if, if, if you're just overexposed to one theme, I think. But it doesn't mean there aren't a lot of other great investment opportunities available out there.

John Jardim:

Alright, true. So thank you for that. Look, we've got, a couple of questions, and we get this quite a lot because there's participants in the market that are sort of coining new terms around value.

But is it possible, and maybe, John, this is... given that you, you've been in markets for a long time, maybe... maybe you can take this one, but is there... is it possible that there's a new concept of value, and that maybe the return to the mean is a mirage, and that value has changed dramatically?

What's, what's your thoughts on that?

John Goetz:

Yeah, well, Dan alluded to it earlier, but the way we measure the performance of businesses, and the value of businesses it has flaws to it. You know, software as a general business model, is expensed as you're developing it, whereas a plant, a physical facility, we know is a 30-year life asset, so we put it on the balance sheet. And then financial shenanigans at companies involve moving things that should be period expense into the balance sheet so it gooses earnings.

Not that GE did that for 10 years in a row, Dan.

They actually did. But anyway, Dad covered GE, where we owned it. But, you know, my point being that what happens is that any simplistic financial metric, price to book, price to earnings, is flawed in its nature, because it's not looking out the windscreen, it's just looking at T0. And that's really the problem in investing. So we do, as value investors, we have to work hard not to except a snapshot. You know, as a prediction of the future. But I think that with enough resource, you can go to work on what is likely in terms of the future range of outcomes. And I wanted to add, since you opened this door, John, you know, I do want to add to everyone listening here, you know, I'm very excited about Daikin, right? Dan's very excited about Baxter. We don't know the future. What we know is a very dark version is priced in. And the hope version isn't even there.

So... so I think that's what's really important. We're looking for valuations that reflect a bleak assessment of the future.

I didn't even, you know, and in AI, that's interesting, right? Because there's a lot of hope in the future already captured in share prices. We're more likely looking at a company where there's nothing represented for AI, you know, positivity. And we nailed that in Samsung. I like to say Samsung was a loser in the AI world, because Hynix had all the high bandwidth memory business with NVIDIA for a while.

But the idea that the long-term world wouldn't require more memory in the AI world, and that Samsung would never have a high-bandwidth memory chip to compete, we were just like, you've now priced that in? That's kind of silly.

And that worked out in a year. I mean, that's just total luck. I'll just say to everyone that we, you know, we made that much money in a year in Samsung. So I'm not implying that, I'm just implying you know, implying that when you buy businesses, that the despair is priced in as the base case, and there is no opportunity in the minds of the market, because earnings have been weak or negative, that... those are the gems. It's really the skew of the outcomes, that we're talking about. And I didn't even notice I held back, John, I didn't even mention that Daikin does have air conditioning for data centers, so, you know.

John Goetz: You know, if someone wants to hype Daikin, they should just say data center. That's not our thesis, but, you know, you could use it.

John Jardim:

Yeah. No, we should maybe send a note to the company to put, you know, more references to data centers in their updated earnings calls, but no, thank you for that. Look, I think maybe let's... let's change tack a little bit here. And so, Dan, I mean U.S. financials, U.S. banks. There's a question here around that relative to Europe, we've talked about that, but sort of more generally, how are you thinking about US financials, and what should investors be thinking about?

Daniel Babkes:

Yeah, so I, I think you know, there's a couple observations I would make. The one is we've been in quite a good environment for the large U.S. banks that we've been invested in over the last couple of years. And just to describe what's been going on from a fundamental perspective, you know, they've really been benefiting from a couple things. So one, ironically, a lot of the things that are causing uncertainty in the world have actually been good for the revenue lines of these banks.

So, if you think about trade policy uncertainty, uncertainty around inflation, which is causing interest rate volatility, this has forced people to have to make adjustments, and it's driven a lot of activity in the world. So, the revenue lines are going up.

You're starting to see now an M&A wave, which is, you know, part of the, you know, hope cycle and optimism in corporate America is taking hold a little bit, plus a better regulatory regime around around antitrust issues. So that's driving good revenue growth for, for the sector, but the uncertainties that have caused that have caused some of this, positive tailwind on the revenue side have not translated into a credit cycle. So you're not seeing high unemployment in the U.S, you're not seeing a big wave of corporate defaults.

So this combination of, you know, capital formation is happening, the volatility in the world is creating a lot of action and good revenue growth, but credit costs staying low means earnings have been growing very fast.

So that's been a great environment. And then on top of that investors had been getting more and more optimistic that the regulatory regime in the U.S. was becoming more accommodative to the banking sector. So, really, since the GFC, that's been a pretty significant headwind to these businesses, and there's been a lot of hope that this administration wanted to start reducing capital requirements in order to stimulate the economy. Now, over the last week or so, if folks have been following some of the news around the sector, there's been some items that have caused investors to question that premise a little bit. So one is, you know, tweets about a 10% credit card interest rate cap, which is, you know, something that's not really feasible from an economic perspective if we want to have a credit card industry in its current form. But there's been some kind of, what I would describe as low probability, high severity tail risk type things talked about in the press over the last couple of weeks, so that's weighed on the sector a little bit in the short term. But, you know, broadly speaking, the banks have been in a good spot because of, you know, the tailwinds that I mentioned and, you know, a broader push towards deregulation. And what I'd say from a valuation perspective.

The starting point was so low for a lot of these investments that after the big run-up, they're not expensive stocks. The opportunity is diminished for the sector as a whole, but it's not gone. And in particular, where we've still maintained exposure are companies where we're finding really interesting company-specific drivers that, that we still think are gonna drive performance going forward. So, you know, a couple of examples of those were companies that had... had regulatory problems that have been... that have been handicapping their business over the last cycle, where those are starting to remove. So Citigroup or Wells Fargo would be good examples of that, or Capital One, where they've just gone through this transformative merger that we think is going to create a lot of value for the company in the coming years.

So those are the types of things where we've still held on to, but we have been on net reducing the exposure as the valuations have improved.

John Jardim:

Thanks, Dan. I think, on last year's podca... last year's webinar at this time, I think Rich, Rich Pzena had, Citi, Citigroup as his, stock pick, so, I think he did well there. So, maybe just, I think we're coming up close to time, so maybe, John, I'll get you to close on one last question.

We've had a couple of... I mean, we've spoken about European equities a little bit already, but we've got a couple of questions here linking European equities to more the question around you know, is the op... is there still opportunities for value investors in European equities? And more so, like, a general question, has the long-anticipated recovery in value stocks, like, already occurred? Like, is there more of a runway? What does that look like?

John Goetz:

Well, I think what's counterintuitive is that the value stocks are always the same industries.

And they're not. You know, the controversies that have really mushroomed. Auto is still there in this nightmare, right? Just look at the stock price of most automotive companies in Europe.

So that crisis has been running through this whole time. But we have new emerging crises, right? We have the luxury crisis, we have the alcohol crisis, you know, crisis where we think these historic, you know, profitable, high-margin businesses are really heading into a dark period. So that composition of our cheapest quintile, the companies that our model, our quant model is telling us, look at these, this looks kind of interesting, right? Because the stock price is really low relative to what these companies made historically. That's just the starting point.

And then we go from there. So the composition has shifted, and I think that's what's interesting in Europe. I have to say, John, to all the people on this call, that the fact that the financials in Europe and Japan had the highest momentum you know, of anything we owned last year, I'm, like, thanking God that, you know, that this actually happened, because, you know, taking advantage of that took a long time. Right? If you look at our performance, those of you who have known us for a long time, financials were a drag Right? On our... on our portfolio performance. So the fact we're able to monetize that, I look at as a very interesting thing, as the opportunity is actually broadened out in the cheapest quintile. And I think that's what's interesting, is that diversity that we want in the portfolio, because we really don't want to just bet on interest rates or the price of commodities.

John Jardim:

Very good. Look, thank you very much, John and Dan. I think we've just gone over time a little bit, so I think I might close it there. For those that we didn't get to your questions, we will definitely reach out to you to provide a bit of commentary and some answers.

But I just want to thank everyone for dialing into this on a Friday morning in Australia, and an evening in North America. So, thank you again, John and Dan, and to everyone listening, we'll see you soon.

Thank you.

John Goetz:

Thank you.