

# Perpetual knowledge bank series: value investing

13 October 2020



Value investing is an investment style which involves identifying stocks that the market appears to have undervalued and are trading at a discount relative to the company's underlying or intrinsic value.

Value investing has a long history with Benjamin Graham considered the founder of the investment style with his seminal work “Security Analysis” in 1934. Warren Buffett became his most famous student, producing returns well above market indices for many decades.

This investment style primarily focuses on looking at individual stocks (often called “bottom up” investing) in contrast with macroeconomic (or “top down”) investors who first look at the economy and macroeconomic trends before deciding what stocks to invest in. In many cases, value investors may have little or no regard for macroeconomic factors since they believe they are not always linked to the main reason why some stocks are undervalued. Individual stock investing is also referred to “fundamental” investing.

Value investors seek to invest in stocks that the market appears to have undervalued, and which are trading at a discount relative to the company’s intrinsic value. It is generally their view that investment markets are only semi-efficient and therefore, they aim to profit from these market inefficiencies through buying and holding the undervalued stock over the time.

A stock may be undervalued for several reasons. It is possible that the stock isn’t “glamorous” or belongs to a less favourable industry, or perhaps it is a lesser known stock and is trading under the radar. Recent negative news stories can also impact a stock’s price, causing it to be undervalued.

The goal in value investing is for the share price of the stock to ultimately align with or trade above the stock’s intrinsic value. Common metrics used to analyse the value of a company are price to earnings ratio (P/E), price to book ratio (P/B), return on equity (ROE) and debt to equity ratio. For example, a lower P/E ratio may indicate that the stock is undervalued, and value investors may view the share price as cheap and attractive relative to the company’s earnings.

At Perpetual, we combine value investing with quality filters to provide our clients with access to an actively managed portfolio which in our view, includes high-quality companies trading at attractive valuations. We identify quality companies through a process of “bottom up” fundamental research and analysis. Before a stock can be considered as a potential investment, it must first pass Perpetual’s four quality filters:

1. Quality of business
2. Conservative debt level
3. Sound management
4. Recurring earnings.

Any stock that passes our quality filters is then ranked 1 (strong overweight) to 5 (sell). Stocks ranked 1 or 2 indicate the high conviction the analysts have in the stock and portfolio managers and the investment team will then look at the valuation of the stock. If they think a stock is undervalued relative to its potential, it may be included in the investment portfolio. This approach means we do not focus on trying to predict where markets and prices are heading, rather making investment decisions based on in-depth research which allows us to understand

the fundamental risks and opportunities of each company held in the PIC portfolio. Through this approach, we aim to minimise downside risk and protect the portfolio during periods of market stress. Our investment teams have a clear and disciplined approach to investing and we have remained true to this investment philosophy through all market cycles.

This analysis has been prepared by [Perpetual Investment Management Limited \(PIML\)](#) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

The information is believed to be accurate at the time of compilation and is provided in good faith. This document may contain information contributed by third parties. PIML and PSL do not warrant the accuracy or completeness of any information contributed by a third party. Any views expressed in this document are opinions of the author at the time of writing and do not constitute a recommendation to act.

The product disclosure statement(PDS) for the Perpetual Diversified Income Fund issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS and Target Market Determination can be obtained by calling 1800 022 033 or visiting our website <http://www.perpetual.com.au> .

No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.