

# Value Investing:

## Poking Holes in the Popular Narrative

Lyrical U.S. Value Equity

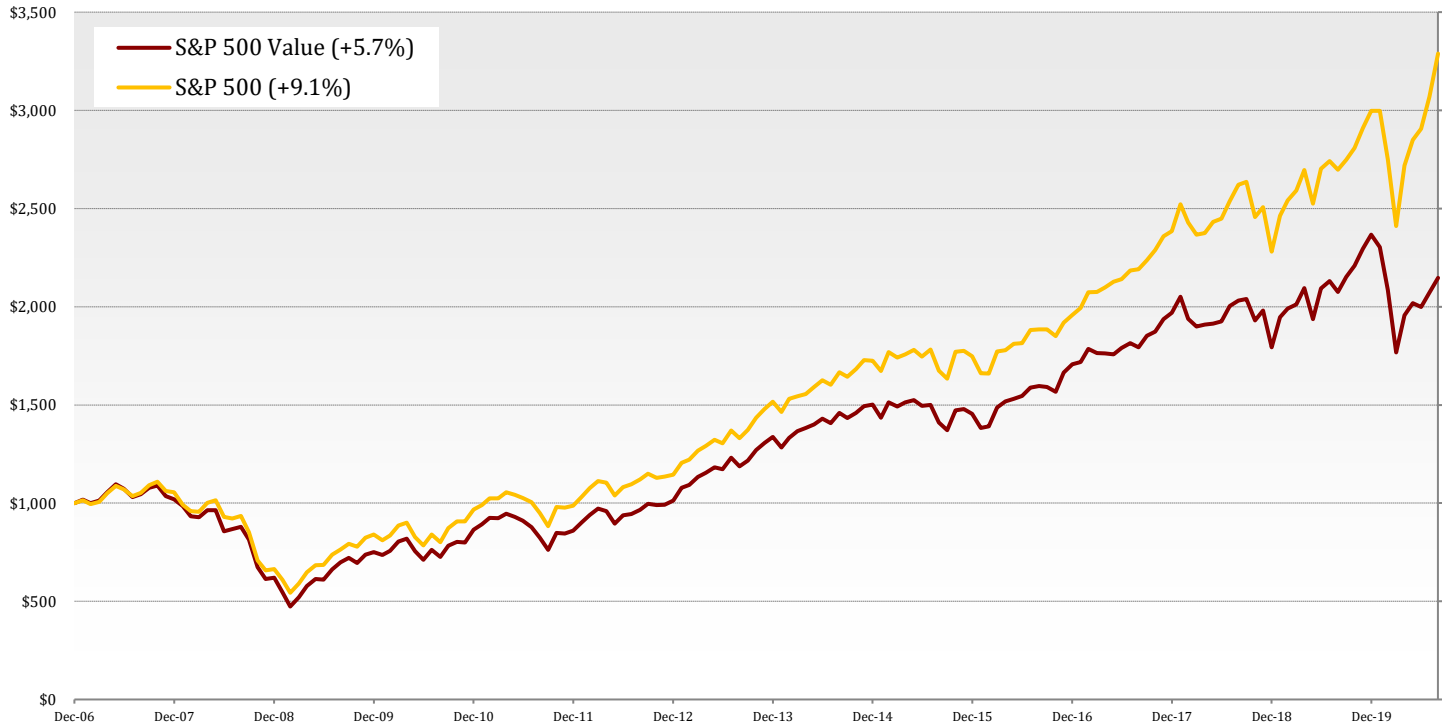
September 10, 2020



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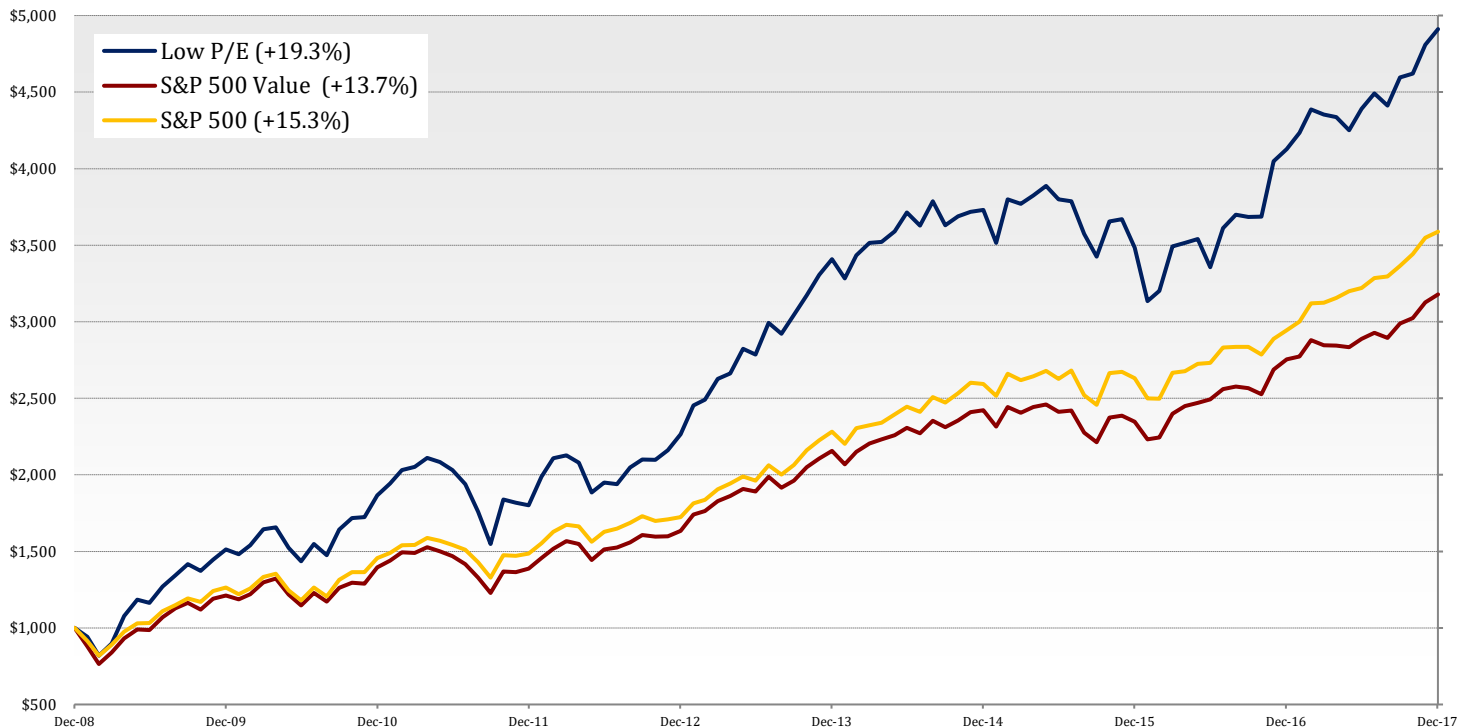
# S&P 500 Value index has underperformed for more than a decade

Growth of \$1,000: January 2007 – August 2020



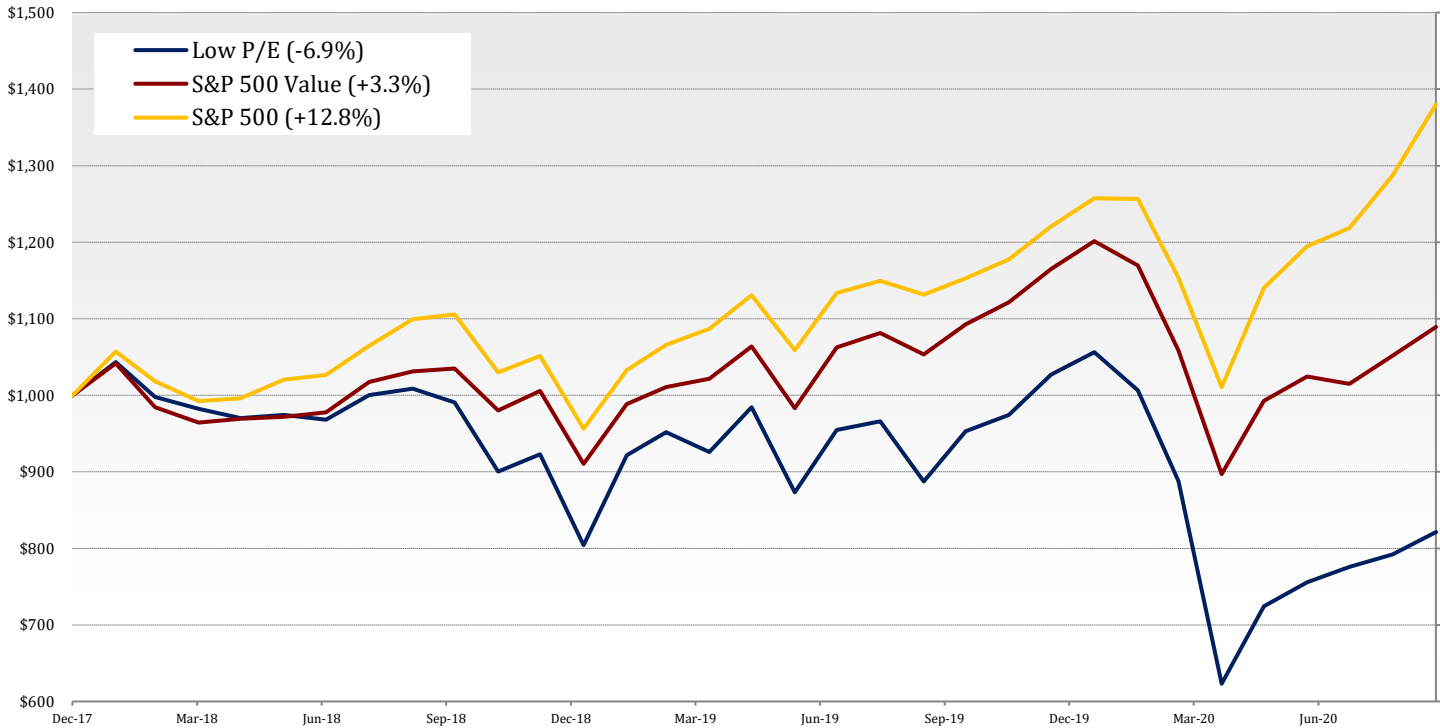
# Yet, value stocks outperformed even as the value index did not

## Growth of \$1,000: January 2009 – December 2017



# Value stocks have only been underperforming since 2018

## Growth of \$1,000: January 2018 – August 2020



# You Can't Get Value From the Value Index

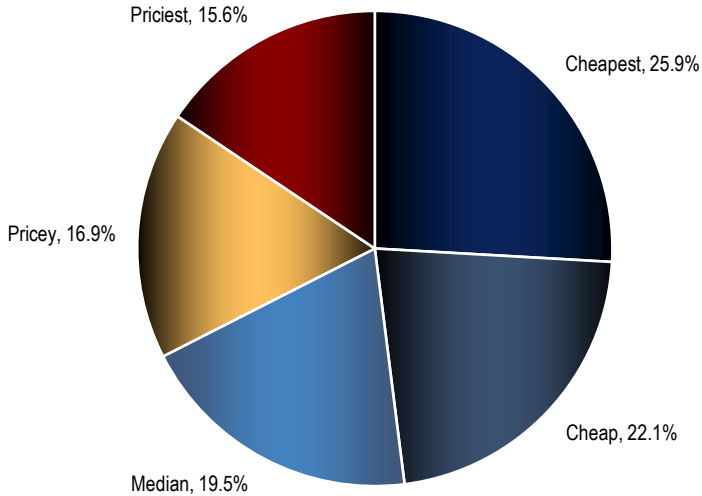
	Low P/E Quintile	S&P 500 Value
<b>Selection Universe</b>	1000 Largest Stocks	S&P 500
<b># of Holdings</b>	200	395
<b>Value Factor</b>	P/E (NTM)	P/B, P/E & P/S
<b>Growth Anti-Factor</b>	None	EPS, Sales & Momentum
<b>Weighting</b>	Equal Weighted	Capitalization Weighted
<b>Passive Share (S&amp;P 500)</b>	12%	62%
<b>Cum. Return ('98 – '20*)</b>	+732%	+301%
<b>Cum. Rel. Return ('98 – '20*)</b>	+279%	-153%

\*As of August 31, 2020, otherwise all data as of 12/31/19.

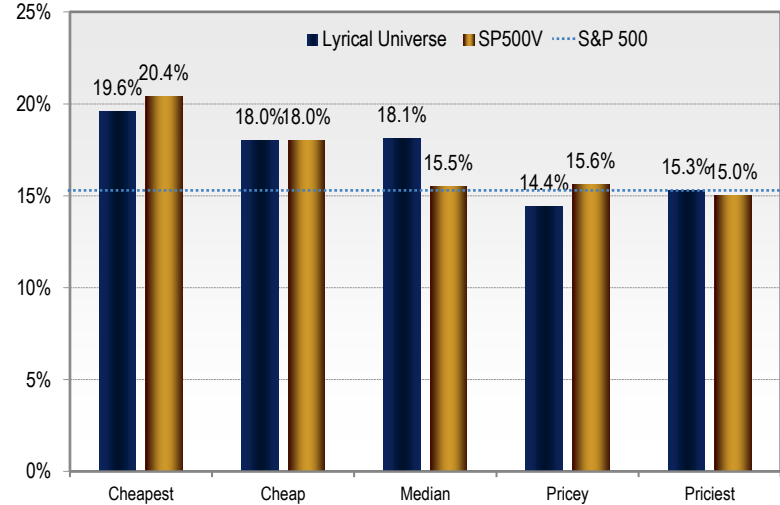
# Most stocks in SP500V are not in cheapest quintile

2009 -2017

### S&P 500 Value by NTM P/E Quintile



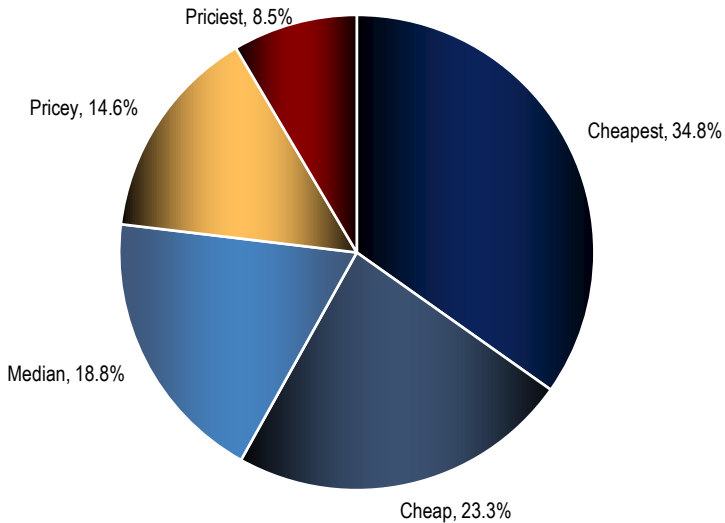
### Annualized Return by NTM P/E Quintile



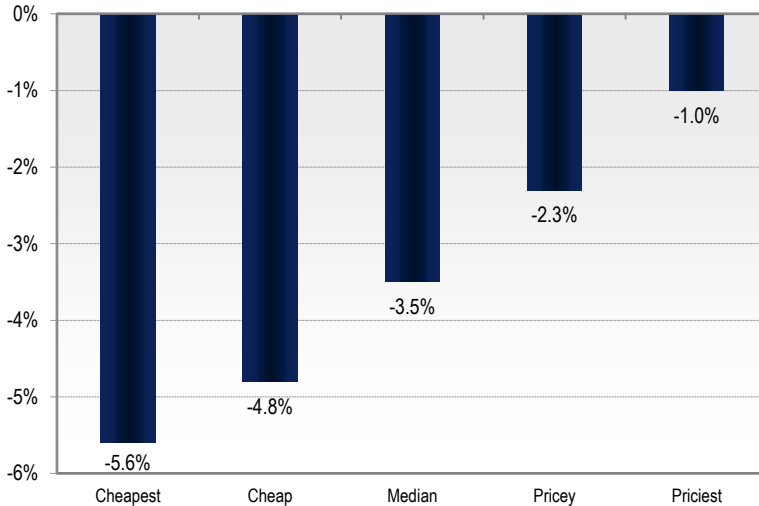
# Capitalization weighting hurts value stock returns

2009 -2017

### S&P 500 Value by NTM P/E Quintile

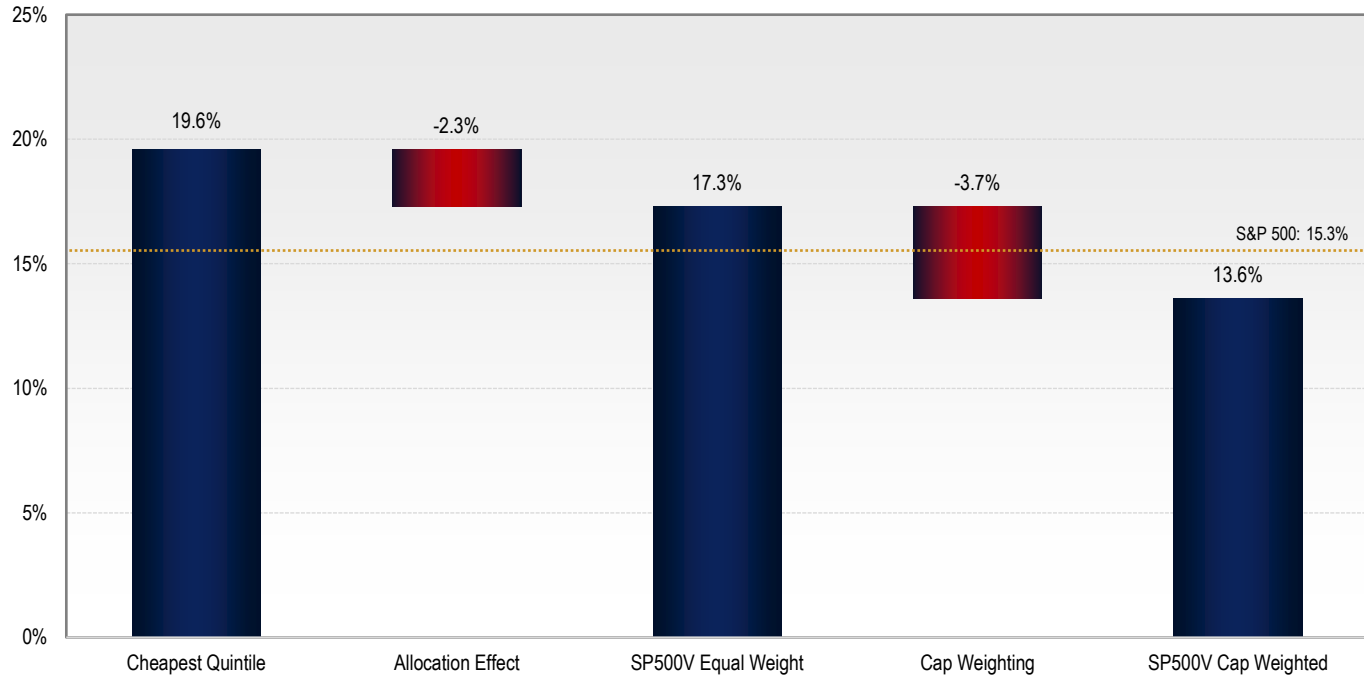


### SP500V Cap Weight vs. Equal Weight Return



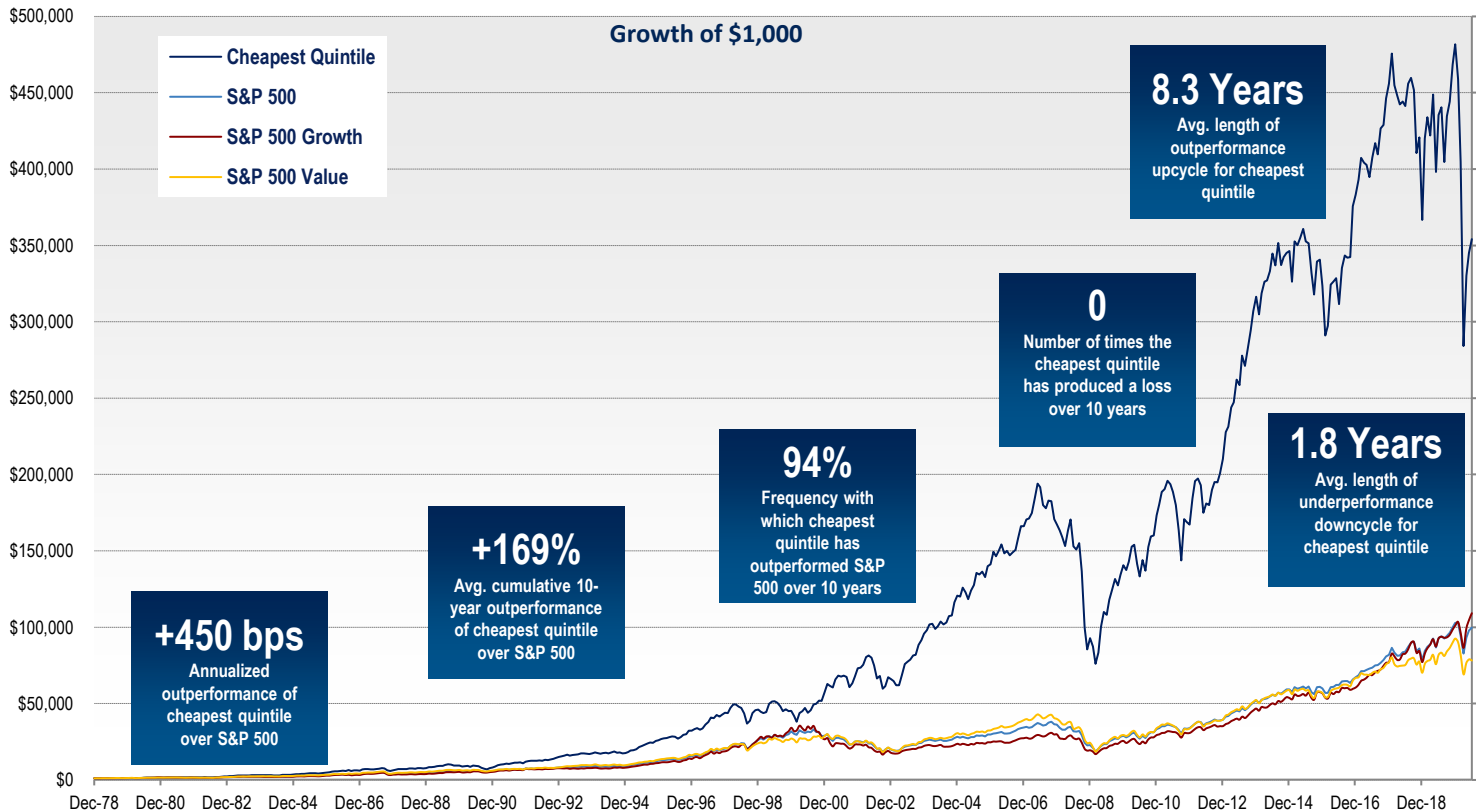
# Performance Attribution of SP500V vs. Cheapest Quintile

2009 -2017





# Why Value Stocks?

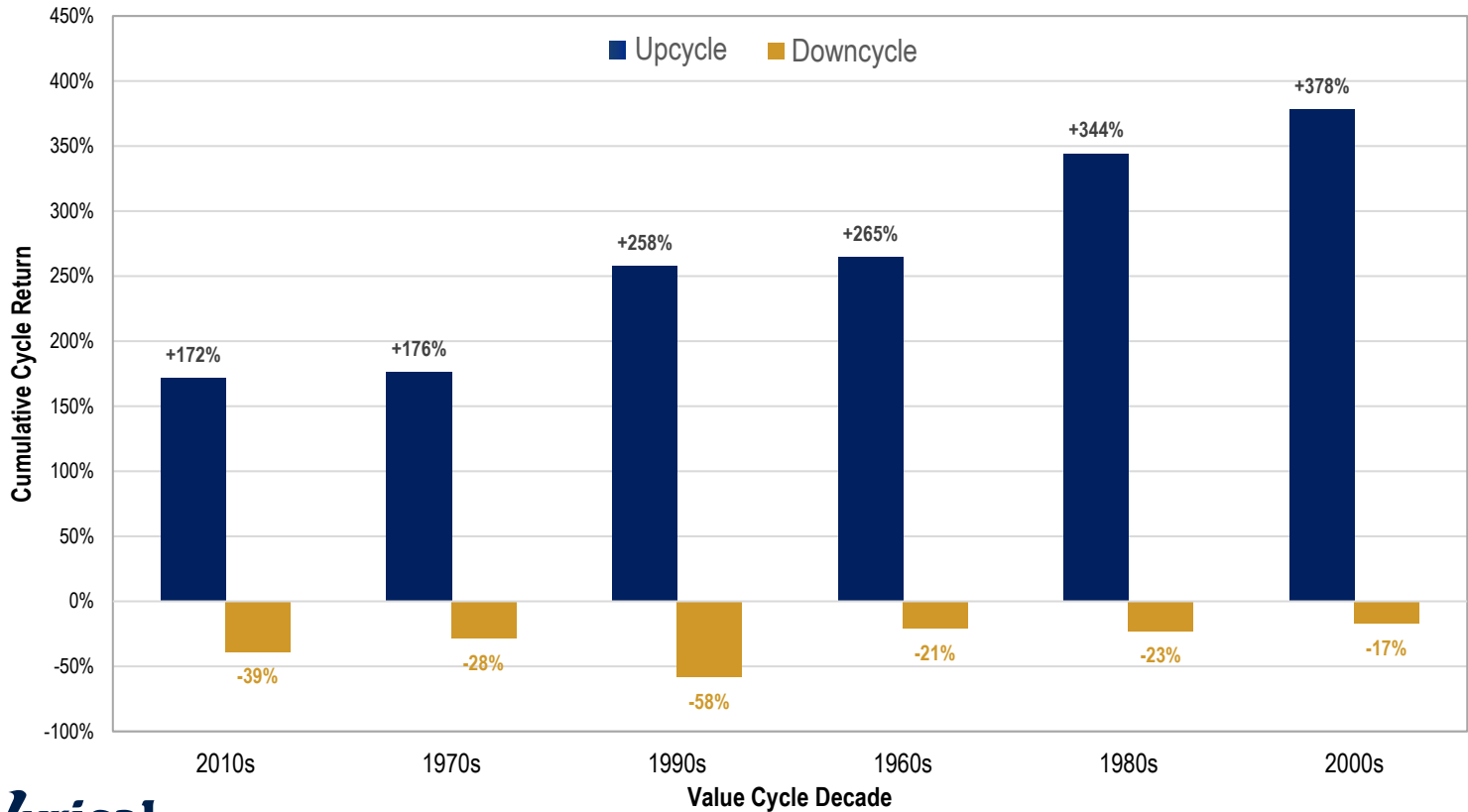


# History of Value Performance Cycles

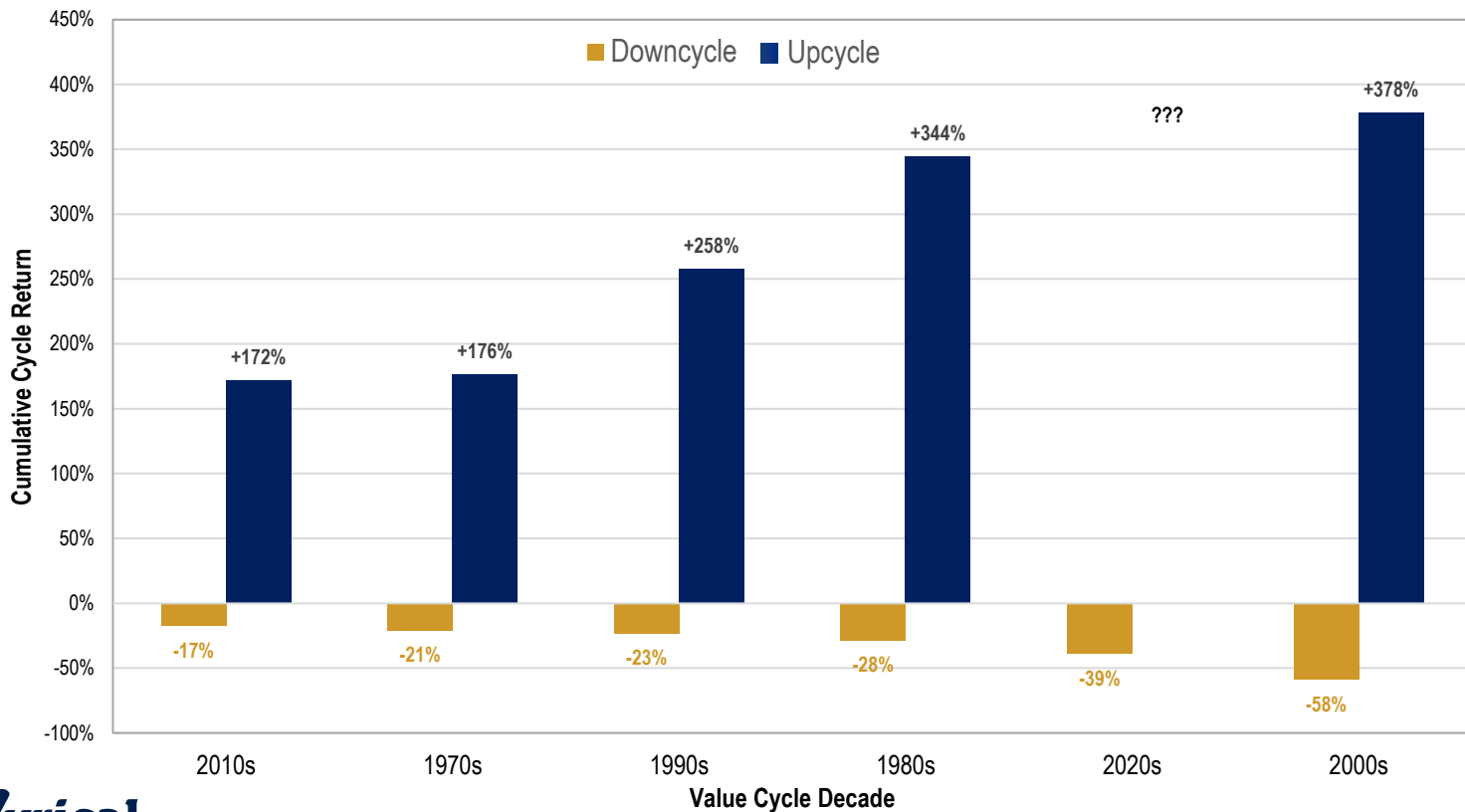
Start	End	Length (Yrs)	Cumulative			Annualized		
			Cheapest Quintile	S&P 500	Delta	Cheapest Quintile	S&P 500	Delta
Jan-60	Feb-71	11.2	477.9%	213.4%	+264.5%	17.0%	10.8%	+6.2%
Mar-71	Jun-73	2.3	-4.4%	16.3%	-20.7%	-1.9%	6.7%	-8.6%
Jul-73	Jul-79	6.1	206.4%	30.4%	+176.0%	20.2%	4.5%	+15.7%
Aug-79	Nov-80	1.3	17.4%	45.6%	-28.3%	12.8%	32.6%	-19.8%
Dec-80	Aug-89	8.8	606.0%	261.8%	+344.2%	25.0%	15.8%	+9.2%
Sep-89	Oct-90	1.2	-32.8%	-10.0%	-22.8%	-28.9%	-8.6%	-20.3%
Nov-90	Dec-97	7.2	544.5%	286.6%	+257.9%	29.7%	20.8%	+8.9%
Jan-98	Feb-00	2.2	-13.4%	45.0%	-58.4%	-6.4%	18.7%	-25.1%
Mar-00	Jun-07	7.3	402.4%	24.1%	+378.3%	24.6%	3.0%	+21.6%
Jul-07	Nov-08	1.4	-55.5%	-38.5%	-17.0%	-43.5%	-29.1%	-14.5%
Dec-08	Dec-17	9.1	434.2%	262.6%	+171.6%	20.3%	15.2%	+5.0%
Jan-18	Mar-20	2.3	-37.7%	1.1%	-38.8%	-19.0%	0.5%	-19.4%
<b>Total Period</b>		<b>60.3</b>	<b>391,624%</b>	<b>35,257%</b>	<b>+356,367%</b>	<b>14.7%</b>	<b>10.2%</b>	<b>+4.5%</b>

<b>Average Up Cycle</b>	<b>8.3</b>	<b>427.8%</b>	<b>152.2%</b>	<b>+275.6%</b>	<b>22.3%</b>	<b>11.8%</b>	<b>+10.5%</b>
<b>Average Down Cycle</b>	<b>1.8</b>	<b>-24.8%</b>	<b>5.4%</b>	<b>-30.2%</b>	<b>-14.8%</b>	<b>3.0%</b>	<b>-17.8%</b>

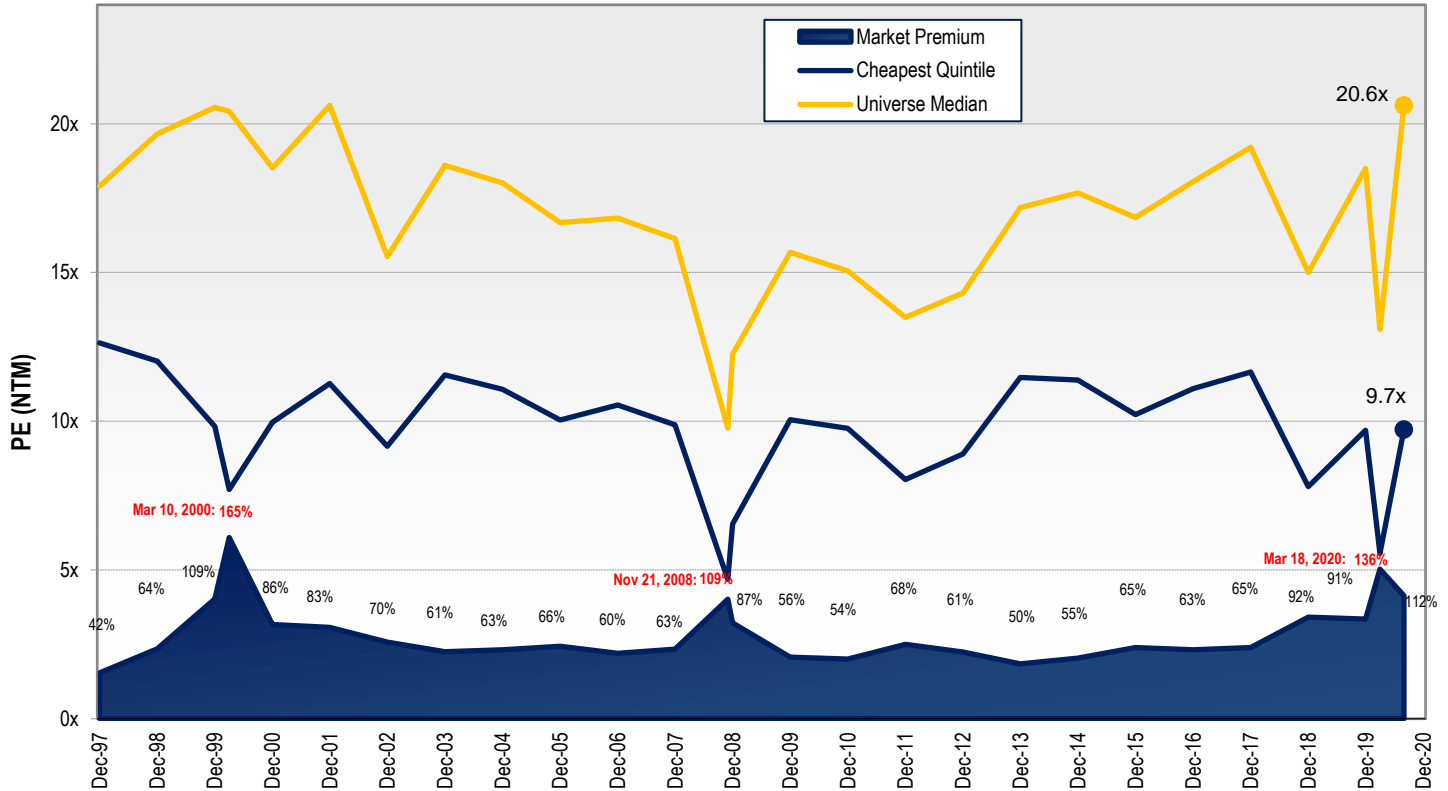
# Strength of Upcycle Does Not Correlate to Strength of Downcycle



# Worse Down Cycles Have Led to Better Upcycles



# Valuation spreads are extreme by historical standards



# Valuation spreads are extreme by almost every measure

Value Spreads, Equal-Weighted Top 1000 Stocks, Industry-Neutral  
December 31, 1967 – March 31, 2020\*

Value Spread Measure	Current Percentile	(Current – Median) / (Max – Median)	Current STD Event
Price-to-Book	100%	100%	+4.2
Price-to-Sales	99%	75%	+2.7
Price-to-Earning (trailing)	100%	100%	+3.1
Price-to-Earnings (forecast)	100%	100%	+5.5
Composite	100%	100%	+5.0

Composite Value Spreads, Equal-Weighted Top 1000 Stocks, Industry-Neutral  
December 31, 1967 – March 31, 2020\*\*

What's Removed	Current Percentile	(Current – Median) / (Max – Median)	Current STD Event
Nothing Removed	100%	100%	+5.0
Remove Tech / Telecom / Media Industries	100%	100%	+5.1
Remove 5% Mega Caps***	100%	100%	+5.4
Remove 10% Most Expensive Stocks	100%	100%	+5.0

Note: Using only the largest 1000 US stocks.

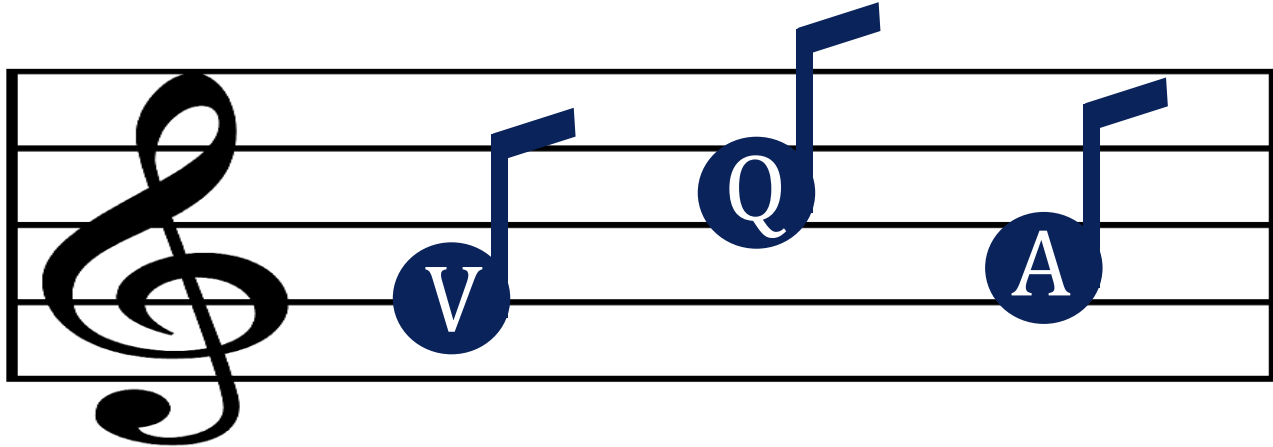
\* Forecasted Price-to-Earnings starts January 31, 1976

\*\* Composite value spread uses four signals: Price-to-Book, Price-To-Sales, Price-to-Earnings (trailing), and Price-to-Earnings (forecast). This portfolio is industry-neutral and equal-weighted using the largest 1000 stocks

\*\*\* Reported here is the composite over all four measures. If we remove the mega-caps within each industry and do the composite over the other three measures excluding forecasted price-to-earnings you get 100%, 100%, +4.7 STD.

Source: AQR (Is (Systematic) Value Investing Dead? May 8, 2020), CRSP, XPressFeed.

# The Lyrical Way is V-Q-A



## Value

Value investing is the best way we know to generate superior long-term returns.

Not just value investing, but **deep value** investing. The deeper the discount, the greater the return (when you're right).

The challenge is separating companies that deserve low valuations from those that don't.

## Quality

In our experience, avoiding low ROIC companies improves the probability of success.

Among the cheapest stocks, we only invest in companies with an expected ROIC >10%.

We avoid certain industries because they do not meet our ROIC hurdle:

- Deep Cyclical (e.g., Airlines)
- Basic Materials
- Regulated Utilities

## Analyzability

In our experience, the easier it is to analyze a business, the greater the probability of success.

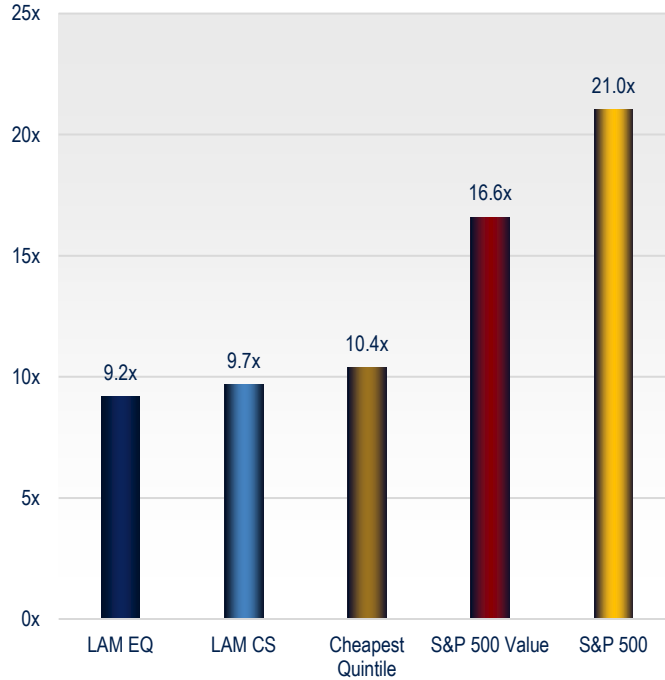
Some businesses are too complex or opaque to analyze adequately.

We avoid certain industries because they lack analyzability:

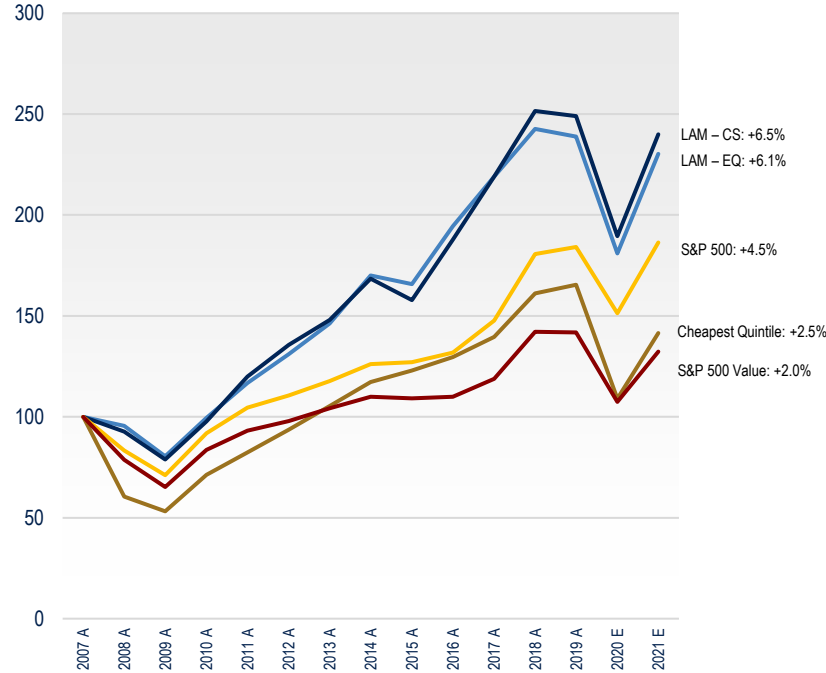
- Banks
- Pharma / Biotech
- Traditional Retail

# Uncommon Combination of Deep Value and Growth

Forward P/E Ratio



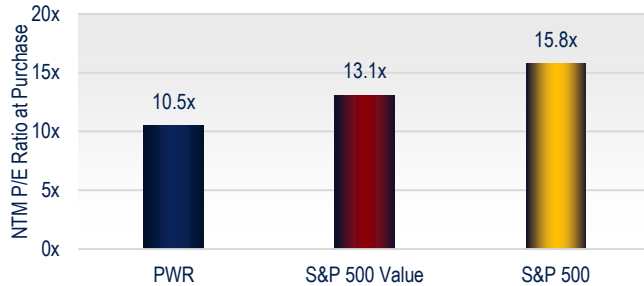
Indexed EPS Growth



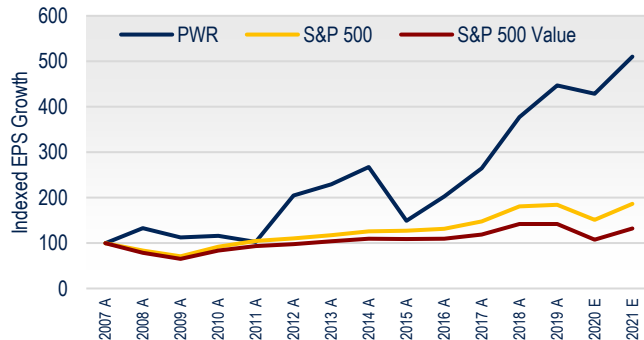


# Example Investment: Quanta Services (PWR) – Purchased Feb 2019

## Value



## Quality



## Analyzability



### Business Background

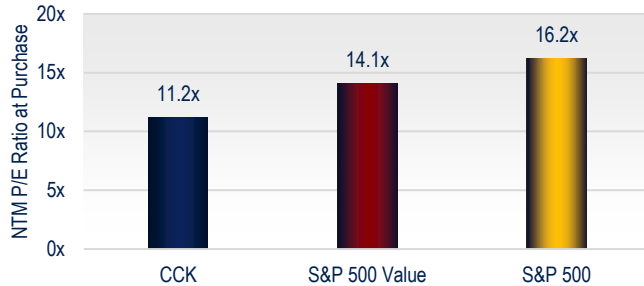
- Provides specialty infrastructure services including maintenance work, emergency repairs, and new project construction
- Has the largest specialty workforce in North America and essentially is an outsourced contractor for many major utility and telecom companies
- Approximately 55% of sales are generated from Electric Power, 42% from Oil & Gas, and 3% from Telecom
- The base of its operations is comprised of maintenance type work that is recurring and inherently stable, and accounts for 80-85% of sales

### Current Trends

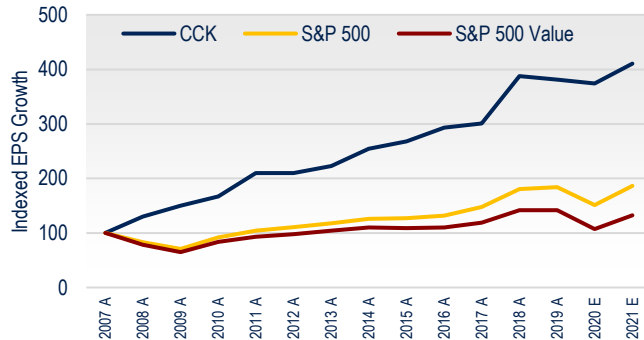
- Attractive 15% return on tangible capital
- Local knowledge, flexible cost structure, skilled employees, mostly pass-through pricing, repeatable revenue, and long-standing relationships all key elements making this a high-quality business
- Has a strong balance sheet (<1x Net Debt / EBITDA) and produces strong cash flow, enabling it to reduce its share count by 32% since 2014
- Telecom business has potential to more than double in size

# Example Investment: Crown Holdings (CCK) – Purchased Apr 2018

## Value



## Quality



## Analyzability



### Business Background

- Second largest global producer of beverage and food cans
- Growth in can business is steady with limited economic sensitivity
- High-quality business with steady returns on tangible capital above 20%
- Plants benefit from dominant local market shares

### Current Trends

- Cans benefit from secular shift in consumption as they are an increasingly preferred method of packaging
- Nearly 60% of beer volumes in the U.S. are now packaged in cans versus only 48% in 2006
- Stable margins as raw material inputs are passed through on customer contracts
- Company recently completed acquisition of Signode, a leader in transit packaging. The acquisition is materially accretive and provides new avenue for growth

# Summary

- Value indices have struggled for over a decade
- However, value stocks performed well after GFC, but then struggled for ~2 years
- You can't get value stock performance from the value index
- Recent value stock performance is consistent with historical value cycles
- The next value upcycle has the potential to be one of the best
- Timing is tricky but upcycle may have started after March 18<sup>th</sup>
- Lyrical seeks to find the “gems” within the “junk”

# Disclaimer

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MARKET DATA IS COURTESY OF FACTSET.

# Important Notes

## Index Information

The S&P 500 Index is a market capitalization weighted index comprised of 500 widely-held common stocks.

The S&P 5000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those S&P 500 companies with lower price-to-book ratios and lower expected growth values. The S&P 500 Value Index is constructed to provide a comprehensive and unbiased barometer of the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

## Returns by NTM P/E Quintiles (Slides 3 – 10, 14)

For each calendar quarter, based on FactSet data, we divided the 1,000 largest U.S. stocks by market capitalization into quintiles based on their beginning of quarter price to median forward earnings multiple. Return for each quintile is the simple average of the total returns, including dividends, of each stock in that quintile. Returns for stocks that ceased trading are included through the date they ceased trading. The universe average is the simple average total return of the 1,000 stocks over the period presented.

The returns reflected in the charts are annualized. This does not reflect the experience of any investor.

## History of Value Performance Cycles (Slide 11-13)

For the period from January 1960 – December 1984 we use Sanford Bernstein data for the cheapest quintile within the 1,000 largest U.S. stocks by market capitalization based on price to book value as the representative cheapest quintile.

For the period from January 1985 – December 1997 for each quarter, based on FactSet data, we divided the 1,000 largest U.S. stocks by market capitalization into quintiles based on their beginning of quarter price to median *trailing* earnings multiple. Return for the lowest p/e quintile is the simple average of the total returns, including dividends, of each stock in that quintile. Returns for stocks that ceased trading are included through the date they ceased trading.

For all periods after 1997 we use the methodology described in the Notes to Slides 3-10 set forth above.

Note that discretion was applied by Lyrical in determining the beginning and ending of each cycle.