

Interview with Portfolio Manager Claus Vorm Nordea 1 – Global Stable Equity Fund

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Please note that the conference call occurred on the 9th of September 2020. All market commentary and information refers to the period before then

Key takeaways

- Equity markets have been dominated by momentum/growth stocks which now trade at very expensive multiples
- Defensive equities underperformed in 2020 due to the unique nature of the sell-off and the subsequent growth rally
- This has led to an extreme valuation gap and a very attractive relative valuation which makes stable/low risk equities a very attractive investment case
- The robust investment process – combining lower risk and attractive valuations – gives us a high conviction for this equity segment and our fund

Defensive/ low volatility equities have been lagging over the last couple of years while growth stocks outperformed, and yet they have not brought protection in the Covid sell-off. Why not?

Since the US election in 2016, there has been a general focus on growth, albeit with some sector rotation. Stable/low risk equities provided protection in 2018 when earning uncertainty and neg revisions captured the market, but in 2019 attention turned back to growth. This year's Covid-driven sell-off was rather different from most market falls. Whereas market weakness usually arises from demand shocks and liquidity issues, this sell-off resulted from a supply shock: many businesses were unable to sell their products during lockdown. We have seen a big split between those whose businesses have been disrupted by Covid, such as the cruise ship operators, and those who have benefited from Stay-at-home, such as Amazon and Netflix. At the same time, far from seeing a liquidity crunch, growth stocks in particular have benefited from Central Bank/ Government support even as the lockdowns ease.

Central Bank actions are clearly distorting risk behaviour and valuation doesn't seem to matter anymore. Is Value investing dead?

The strong style bias in the market for growth is currently driving index performances. Factors like growth/value can underperform for quite some years but this is also when they accumulate a lot of value. The last time we saw anything like the current valuation gap between growth and value stocks was in the IT bubble. If history is any guide, this extreme valuation gap should remind us that low valuations with a sound development of underlying fundamentals are traditionally a strong source of future returns. When a market segment is overlooked and becomes undervalued, this usually represents a good opportunity.

Tell us a bit more about the divergence in performance between growth and low volatility/ value stocks

The stocks that have performed strongly were already very big in the index so their outperformance had a big impact on "market" returns. The "big five" (Amazon, Facebook, Netflix, Microsoft and Google) hugely outperformed more traditional stocks – especially value stocks – in the first 8 months of 2020. This degree of outperformance led to greater weight in the index, and investors chased them higher. These stocks are now pricing in very high growth levels (30-35% longer term growth for Amazon and Netflix, which trade around 60x earning): slight disappointments might result in severe price risk. This is why we do not own stocks like this in the Nordea 1 – Global Stable Equity Fund.

Year-to-date performance of different indices



Source: Nordea Investment Management AB, Multi Assets. Date: 31.08.2020. It is not possible to invest directly in an index. For illustrative purposes only.

What might change this extreme valuation gap between growth stocks and more defensive, stable equities?

The most obvious destabiliser of the high valuations currently placed on growth stocks would be if they failed to meet earnings expectations. Trading on such high multiples, there is little leeway for disappointment here. Other factors that might rock the current growth-momentum trend could be different types of newsflow that affect the market more broadly, such as the US election or a Covid-19 vaccine, or a worsening macro picture.

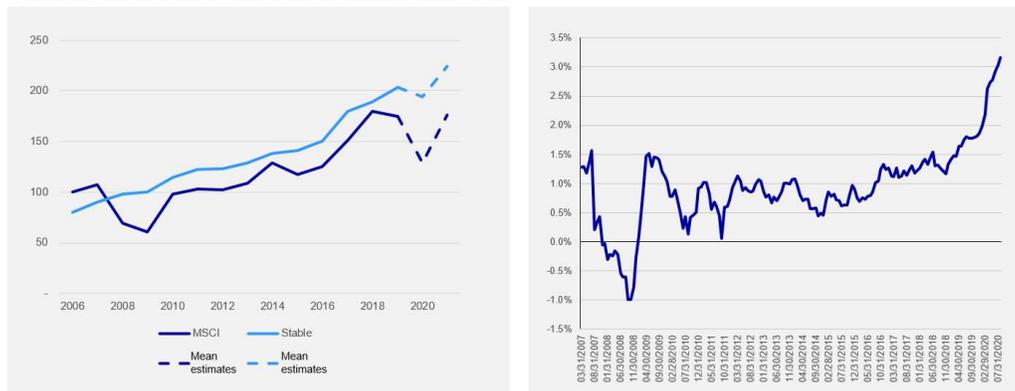
What is your current view of the portfolio and how do you capitalise on opportunities?

The key features we have always focused on are stability in the underlying company fundamentals and attractive valuation. We do not buy pure value stocks, which risk becoming a “value trap”: strong fundamentals support our portfolio. The historic and forecast earnings growth of our companies is much more stable on than that of the broader market. The misalignment between the fundamental development of our Stable Equities and the performance has created a huge valuation gap between the market and the portfolio and we find the current valuation very attractive. The combination of strong expected earnings development for the stocks in the portfolio and attractive valuation gives us a very strong conviction. We believe that Stable Equities are a very strong investment case.

The earnings picture for Stable Equities is strong and valuation looks very attractive

Earnings growth and div for Stable Equities and MSCI World Index

Relative 12M forward earnings yield (Stable – MSCI)



Estimated dividend yield based div yield as August 30, 2020 (2.1% for MSCI World and 2.8% for Stable Equities). Source: Nordea Investment Management AB, Multi Assets. Internally calculated by the investment team. Period under consideration: Realized data for the period 31.12.2006 – 31.12.2019, estimated data for the period 31.12.2019 – 31.12.2021. Please note that the strategy has no benchmark; the index is used for comparison purposes only. It is not possible to invest directly in an index. Stable refers to Nordea Global Stable Equities Strategy. MSCI refers to MSCI World Index 100% EUR hedged. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of your investment can go up and down, and you could lose some or all of your invested money. The presented figures are estimations of Nordea Investment Management AB and are based on assumptions and on information currently available. No guarantee can be given for the accuracy of the data and these estimations might not be met in the future.**

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