THE GLOBE AND MAIL

Value opportunities still exist in shift to stock-picker’s market

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SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 4 HOURS AGO

Estee Lauder Companies Inc. saw its skin care sales increase during lockdown and margins improve with direct-to-consumer online sales, but the makeup, fragrance, and duty-free segments of its business are expected to come back as economies reopen and travel resumes. REUTERS/Lucy Nicholson/Files

LUCY NICHOLSON/REUTERS

Encouraged by rising interest rates on long-term bonds and optimism over global reopening plans, the rotation toward value and cyclical names took hold late last year and is expected to continue as economic activity picks up. But while opportunities are arguably not as plentiful as they were a few months ago, portfolio managers say there are still pockets of value to uncover in several sectors.

Value stocks began to move in November after underperforming their technology and growth counterparts for the past few years. In the first quarter of 2021, the MSCI World Value Index produced a return of 9.76 per cent, in U.S. dollars, compared with 0.29 per cent for its growth counterpart.

But Keith Richards, president and chief portfolio manager at ValueTrend Wealth Management Inc. in Barrie, Ont., says that while opportunities in value and reflation plays were abundant from a technical perspective early in the sector rotation late last summer and into the fall, it has since become a stock-picker's market.

"Six months ago, I had too many ideas, I didn't know what to buy, there were so many [options]," he says. "Whereas now, I'm like, 'Okay, well, there's this one.'"

Mr. Richards, who says he moved into reflation stocks last year when "everybody was still talking about technology," recently lightened his holdings in sectors such as energy and metals after recognizing they have become technically overbought. At the same time, he says he still likes reflation stocks as the demand for materials by China and India is growing exponentially and the thesis behind inflation is sound.

Rather than focusing on value versus growth, Mr. Richards starts with technicals and defines the market in phases. In this phase, with his stock screen showing fewer names setting up in a favourable way, he is holding more cash, as well as choosing low-beta stocks selectively that are emerging from a technical base rather than opting for broad index exchange-traded funds in certain sectors.

For example, although many names in the consumer staples sector don't stack up from a technical perspective at the moment, a few have recently met his criteria, such as The Kraft Heinz Co. KHC-Q (/investing/markets/stocks/KHC-Q/) -0.69% ▼ .

The stock was trading at more than US$90 in early 2017 and hit a low of around US$22 at the early stages of the pandemic in mid-March, 2020, before reaching, and eventually breaking through, a ceiling, likely signalling the beginning of a new phase, Mr. Richards says. That, along with the fact that the company had new management in place, provided a case for the stock, which is currently trading at around US$41.

"We have a catalyst and we have the chart agreeing, so that's a value stock to us," he says. "You could say value is just stuff that is not technically overbought like crazy. It doesn't mean it's traditional value, as in low price-to-earnings."

Norman Levine, managing director at Portfolio Management Corp. in Toronto, says the current opportunities are mostly two-fold: the move from growth and momentum to value and cyclical, and the reopening trade.

"A lot of value stocks, which had been languishing and selling for ridiculously low multiples, have started to move, and that's where you've been getting your outperformance," he says.

A long-time value investor, Mr. Levine still holds mostly value names but also started adding some growth-at-a-reasonable-price stocks last year.

One such stock is Estee Lauder Companies Inc. EL-N (/investing/markets/stocks/EL-N/) +0.78% ▲ , one of the world's largest manufacturers of makeup, skin care, fragrance and hair care products. Although he says its skin care sales increased during lockdown and margins improved with direct-to-consumer online sales, the makeup, fragrance, and duty-free segments of its business are expected to come back as economies reopen and travel resumes.

Elsewhere, Mr. Levine also holds European lens manufacturer, frame and sunglass company EssilorLuxottica SA EL-N (/investing/markets/stocks/EL-N/) +0.78% ▲ for its position as a reopening story given the pent-up demand for these products in many regions.

In the travel space, he likes Spain-based Amadeus IT Group SA AMADY (/investing/markets/stocks/AMADY/) +1.93% ▲ , which provides real-time search, pricing, booking, ticketing, and processing services to travel providers and agencies. The company, he says, had a strong balance sheet, which enabled it to weather the challenges of the pandemic without borrowing money or selling more stock.

Sean Oye, a portfolio manager with Nicola Wealth Management Ltd. in Vancouver, says investors need to be selective this year, focus on fundamentals and quality, and not just buy cyclical stocks because they're going up.

"Last year, you could just go all-in on information technology and benefit from work-from-home stocks, but now, the market is definitely broadening out and you have to be able to choose your names," he says. "It actually might be even better for stock-picking this year, because last year, [you saw] a lot of poor quality companies go up and valuations reach nosebleed levels."

His team is currently seeing opportunities in U.S. financials, with the money for the more cyclical trades coming from utilities, staples and technology.

Mr. Oye points to J.P. Morgan Chase & Co JPM-N (/investing/markets/stocks/JPM-N/) +0.25% ▲ , in particular, which he says has seen growth in deposits and transactions via digital banking and is expected to release a third of its reserves that it built up sometime this year.

"There's a lot of good things going for companies like J.P. Morgan Chase, just not the reserve release," he says.

"Why the cyclical stocks are performing is because we're starting to see interest rates [on long-term bonds and associated credit products] go up. We've seen them increase drastically in the first quarter. That's helping a lot of the banks on their net interest margins," Mr. Oye says.

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