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Think differently if you want to outperform

Investors in the Australian share market cannot afford to ignore valuation risks, while those investing globally need to challenge themselves to step outside their comfort zone if they wish to achieve outperformance.

These were the messages delivered today by contrarian fund managers Allan Gray Australia and Orbis Investments at their annual joint Investment Forum in Sydney.

A lack of concentration on concentration risk

Many ASX 300 Index investors are now exposed to significant valuation risk because of near-record recent multiples in just a handful of stocks, according to Allan Gray.

Managing Director and Chief Investment Officer, Allan Gray, Simon Mawhinney said that historical data indicates an easily discernible trend: the higher the starting valuation, the lower the expected future returns.

“The recent period of strong share market performance and price insensitive investment flows appears to have led to significant market dislocation and stretched fundamentals,” said Mawhinney. “Trade tensions, populist politics and monetary policy have become front-of-mind distractions, shifting attention away from long-term fundamentals.”

At its peak last December, valuations in the S&P 500 were extreme, with its CAPE ratio reaching 36.5x, well above the historical average of 21.8x. While the ASX 300 has traded at less extreme valuations, there is clear evidence that concentration risks abound in the stocks that have driven the Australian index higher in recent years.

Mawhinney noted that while the ASX 300 has a diverse range of companies, just eight stocks — the big four banks, Wesfarmers, Goodman, Aristocrat and Macquarie Bank — delivered 85% of the index return in 2024 despite only representing 28% of the overall market’s capitalisation, further increasing these companies’ weights in the ASX 300. These “hateful eight” companies have dominated stock market returns over the past three years. The other 292 companies have delivered modest to very low returns in aggregate and look far cheaper than the index heavyweights.

“The Australian index is now extremely concentrated. Passive, index investors are currently knowingly or unknowingly allocating a huge part of their exposure to banks, which are trading at eye-watering valuations”, Mawhinney said.

“A purely passive approach may leave you exposed to heightened valuation risks at the moment.”

Mawhinney noted that the Allan Gray Australia Equity Fund is underweight the large companies that dominate the index, due to its contrarian investment style, and has a more diverse range of performance drivers. The fund trades at a 14.7x P/E ratio compared to over 19x for the ASX 300.

Ditch conformity for conviction

According to Orbis Investments, despite Investors being rewarded over the past decade for buying size, growth, and familiarity — often regardless of price — it was well past time to think differently.

Simon Skinner, Head of Orbis's Global Investment Team, said that the equity market narrative rewarding 'size and sameness' has little foundation and is unlikely to serve investors going forward.

"These messages — buy at any price, big is good, and persistent US exceptionalism — have sunk deep into the system. They are shaping how portfolios are built, how benchmarks are tracked, and how stories about markets are told," said Skinner. "And to be fair, they're not without merit — they reflect patterns that have worked exceptionally well in recent years. But these patterns aren't principles — they're trends."

Drawing on Orbis research, Skinner said data shows that on nearly every measure, the last decade's equity markets' performance compared to the last 50 years looks like an outlier and has contributed to a global index heavily concentrated in the US and a handful of massive stocks rather than a diversified benchmark.

"Diversification isn't about holding more stocks. It's about holding different ones," said Skinner. "And that takes conviction. We believe this is a moment to lean into it."

Skinner said that while investors may take comfort from conformity, this rarely leads to outperformance over the long term and investors need to embrace more complexity. "This isn't about avoiding the index. It's about owning businesses that offer what the index cannot: independent drivers of return," he said.

Orbis as a bottom-up, contrarian investor is finding opportunities around the globe with founder-led businesses such as Smurfit Westrock, and also within Emerging Markets. "Despite representing a sizeable proportion of the global population and global economic output, Emerging Markets account for just 10% of major indices — and even less in many Australian retail portfolios. On a cyclically adjusted basis, they are trading at a 55% discount to US equities", added Skinner.

"We believe our approach — grounded in valuation, powered by research, and a willingness to be patient — positions us to benefit when the narrative turns."

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About Allan Gray Australia

The Allan Gray investment philosophy is to take a contrarian approach, apply it consistently and invest for the long term. This approach was started by Dr Allan Gray who founded Allan Gray Ltd in Cape Town in 1973. Allan Gray in Australia and globally are privately owned and share the same investment philosophy. Allan Gray Australia was established in 2005 and launched its flagship Allan Gray Australia Equity Fund in 2006, followed by the Stable Fund in 2011 and the Balanced Fund in 2017. For more information, go to allangray.com.au.

About Orbis Investments

Orbis has been investing in undervalued and ignored global stocks for over 30 years. Their international team of 60+ investment professionals concentrate on unearthing companies trading for less than they are worth, rather than timing market trends. Orbis has applied the same fundamental, long-term and contrarian investment approach since its inception and has over A\$60 billion in assets under management.

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