CONTRARIAN INVESTING

Allan Gray Press Release

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Expensive markets and questionable growth expectations are potential investor pitfalls: Allan Gray and Orbis

Investors in the Australian share market face one of the most expensive markets in over 20 years and need to be discerning, while those looking for opportunities globally could be trapped in poorly diversified strategies predominately invested in companies facing significant growth challenges.

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

Local market at a 'premium'

Nearly every sector in the Australian share market is more expensive now compared with long-term medians.

Allan Gray analysis shows that valuations for nearly all sectors are significantly above historical forward price/earnings ratios, based on weekly weighted average sector valuations since 2000.

The Information Technology sector is currently the most expensive, with a median forward P/E ratio of around 120 times. Health Care was the next most expensive, at around 36.4 times, followed by Communication Services, at around 27.4 times.

"Some sectors in Australia are eye-wateringly expensive across several valuation metrics," said Simon Mawhinney, Managing Director, and Chief Investment Officer at Allan Gray Australia. "Finding genuine value in the current environment is difficult and investors need to be especially discerning. The price you pay for shares is paramount and will make a big difference to future returns. There are opportunities, but you should be selective in allocating your capital."

Only three sectors —Utilities (14.4 times), Energy (11.5 times) and Materials (11.9 times) —are trading at a discount relative to historical valuations. "Our Funds are overweight those sectors trading at a discount to their historical valuations as this is where we are finding opportunities", Mr Mawhinney added.

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Allan Gray also found that this situation was not unique to Australia. Share markets internationally are also expensive compared to long-term medians, except for the MSCI World ex-US, MSCI Europe and MSCI China.

"Over the past 50 years, across a broad range of valuation metrics, global share markets have only looked more expensive at the top of the tech bubble around the turn of the century. Exceptionally strong equity returns in 2023, largely driven by increasing multiples, have pushed valuations to quite extreme levels", said Mr Mawhinney.

"It is hard to say what the immediate future will look like. Valuations could always be stretched further, but current levels do point to a need to exercise caution when allocating capital."

Global market 'concentrated'

According to Orbis, investors should question whether and how today's biggest global companies can continue to achieve the massive growth needed to justify valuations.

The global equity fund manager says investors are paying high multiples for companies that are already huge and face significant challenges maintaining expectations for the growth implied by today's prices. Investors are blindly following the World Index at a time when it is highly concentrated in huge companies.

Orbis looked at the effect of the 'Magnificent 7' companies —the tech giants leading the market up since 2022. It found that these companies, and those that share similar style characteristics like high growth and low cyclicality, make up 60% of the World Index—exceeding the concentration levels seen in the tech bubbles of 2021 (43%) and 1999 (58%).

"The question investors should be asking is, how are these huge stocks going to continue to meet the growth expectations that are now baked-in to share prices?", said Eric Marais, Investment Specialist at Orbis.

"For example, for Apple to grow earnings at 20% this year from its current level requires it to make a new company the size of Walmart, or close to 20 times the size of Woolworths, in a single 12-month window.

"Investors buy broad-based passive funds thinking they are diversified. But today, the World Index has 17% invested in just seven companies, 31% in technology sectors, and 64% in a single country and currency (US)."

Orbis says this concentration issue is not confined to indices and passive strategies, as some of the largest long-only global equity funds in retail use in Australia can have an even bigger growth bias than the World Index.

"We believe investors need to look across a broader opportunity set", said Mr Marais.

One area in which Orbis is finding opportunities is Korean banks. "Korea is pushing its companies to unwind crossholdings, distribute excess cash and raise dividends—much like Japan has done recently. It will take time, but ultimately, we think they'll get there as payout ratios increase, turning 20%+ earnings yields turn into real cash flow yields."

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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 confidently 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.