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Q&A

Volatility Means It's Time for Value Investors to Pounce. Here's Where to Find the Best Bargains.

By Lauren Foster

Sarah Ketterer, CEO of Causeway Capital Management
Photograph by Jonathan Zizzo

Sarah Ketterer has value investing in her blood. Her father, John Hotchkis, founded domestic value manager Hotchkis & Wiley, where Ketterer got her start in asset management and met her future business partner, Harry Hartford. In 2001, they formed Causeway Capital Management, a value-oriented, global investment manager.

"That was our opportunity to brainstorm how we could take a traditional value investing approach—a real echo of Benjamin Graham's teachings—and then apply it to the international markets that were fairly nascent at the time," says Ketterer, who oversees $45 billion as chief executive officer of the firm.

Its flagship Causeway International Value fund (ticker: CIVVX) has outperformed its benchmark since it launched in 2001.

As she notes, it has been a "deep and chilly" winter for value. Until recently, value stocks trailed growth stocks. Now, in the face of pernicious inflation and rising interest rates, investors are rotating out of growth stocks and into value, and the permafrost is thawing.

Ketterer recently was named to Barron's 2022 list of the 100 Most Influential Women in U.S. Finance. From her office in Dallas, she spoke with us about today's market environment, attractive investment areas, and the outlook for value investing. An edited version of the conversation follows.

Barron's: It is an extraordinary time to be an investor: two years of a pandemic and now war in Ukraine. How are you thinking about the markets?

Sarah Ketterer: It is unusual to have two crises back-to-back. Usually, there's some sort of gap. I can see that investors are uncomfortable and nervous. But what drives markets are earnings and liquidity. We knew before Russia invaded Ukraine that we had moved out of the monetary-expansion cycle just about everywhere but China, and to a monetary-tightening cycle. This is sobering for markets. It means there is less money looking for a home, and asset-price inflation likely turns on its head and becomes asset-price deflation. It's just a question of at what speed and at what magnitude.

Big market dislocations often lead to periods of significant outperformance. How are you taking advantage of the current situation?

I cut my teeth in the 1997 Asian financial crisis. I was covering Asia then and was baffled to see stocks trade down to the level of cash on their balance sheets. That's got to be the biggest buy I've ever seen. And the subsequent crises brought about those same opportunities. Today is no different.

When pessimism rises and other investors are taking losses, a value investor can do well. And a value investor with quantitative risk controls does even better.

So, what are you buying as others sell?

We try to determine the best entry points because you don't want to be too early. Adding specific exposure at the right time is what distinguishes great portfolio managers from so-so portfolio managers.

Banking stocks, particularly in Europe, have fallen because of their proximity to the war and suspicions that they have exposure to Russia, Ukraine, and Belarus on their balance sheets. Many have plunged in price, and valuations are hovering around the levels of March of 2020, which wasn't dissimilar from their valuations during the 2012 European financial crisis. Yet, their balance sheets are demonstrably better than back then, by several multiples of equity to assets.

They've been through the regulatory wringer and are on the cusp of paying considerably more excess capital and future profits back to investors in buybacks and dividends. And yet, investors dumped them after Russia invaded Ukraine on Feb. 24 and in the days that followed. It was one of these incredible opportunities.

In crises, markets often price stocks for the current environment as if it will last into perpetuity. We make an assumption about the cycle, and that's a big difference.

Which European bank stocks are you buying?

We bought ING Group (ING) and UniCredit (UCG.Italy), the two that were hit hardest after the invasion. They are trading at massive discounts to tangible book value.

Where else do you see opportunities?

We bought stocks that were Covid disasters because we expected that management could improve the businesses so much that when the pandemic subsided, the stocks would have a huge upswing and the underlying companies would be more profitable than prior to the pandemic.

We bought Rolls-Royce Holdings (RYCEY), the British maker of aircraft engines, during the pandemic, and also recently. We also like Ryanair Holdings (RYAAY). It's the lowest-cost carrier in Europe and has the newest fleet. Pent-up demand for travel is gigantic. Ryanair operates a highly efficient new fleet of aircraft, so they've got the greatest fuel efficiency.

We also picked up Alstom (ALO. France), the French rolling-stock maker. It's mainly a rail and equipment business. We started buying that last year, and the invasion of Ukraine made it a more interesting situation.

The market considers any exposure to Russia toxic. But being in this part of the transportation sector, especially a company that offers this sort of equipment and service, we think is a very good business, ultimately.

Alstom made a tough acquisition last year and have had difficulty integrating it. We got it even cheaper because of its association with Russia. Alstom has a 20% stake in Russia's largest rolling-stock and rail-service company, last valued at 480 million euros [$532 million]. Even if the Russian company stake goes to zero, we expect no impact on Alstom earnings. My colleagues and I think this Russian risk has been fully discounted by the market, arguably several times over.

Right now, we're looking for companies that can pass on increased costs. We think Alstom and Ryanair can do so.

What do you see beyond transportation?

An area that's been fantastic in a crisis has been healthcare stocks, specifically pharmaceuticals. You'd think they'd be great in Covid and some were, some weren't. But in an invasion, that's where the ballast is in a portfolio. They have tremendous cash flow and must be innovative. And, generally, these companies don't have supply-chain problems and inflation pressures to the degree that plagues other industries.

European pharmaceuticals dominated our list because they traded at discounts to their U.S. peers, so we bought shares of Novartis (NVS), AstraZeneca (AZN), and Roche Holdings (RHHBY).

Do you own any Russian stocks?

We don't. Our emerging markets portfolio, managed largely quantitatively with a fundamental risk control, was modestly overweight the benchmark, meaning we had less than 2% in Russia. We sold.

What is your outlook for emerging markets?

China is the largest of the emerging markets. The country is slowing and going through a bit of a growth headwind, but the stocks have sold off so much that the opportunities are fantastic. If you started from scratch, China could end up leading the emerging markets basket into attractive returns relative to the developed world.

Earnings and liquidity are the two most important components of how markets will do. And right now, China's in adding-liquidity mode.

With China, what are you monitoring most closely?

Geopolitics is No. 1, because everything we do at the stock level could be cast asunder if we get the relationship between China and its trade partners incorrect. We don't want to get overexposed to a market and find that there's a major trade spat.

There's plenty more risk. The regulatory environment looks severe, but as long as regulation is well-signaled, reasonably rational, and consistent, it sets up parameters and companies work around them. It's a sign of a developing market rather than an emerging market.

In China, the internet giants that have no obvious regulatory headwinds have the largest weights in our China fund. JD.com is China's dominant, one-stop, multiproduct e-commerce platform. JD also has a controlling stake in JD Logistics, a fast-growing supply-chain and logistic-services company in China. It's trading near its historical valuation low, yet has very promising long-term growth potential.

Which other emerging markets are you keen on?

Our process in our emerging markets portfolios is a combination of top down and bottom up. The bottom up is more significant. Asia continues to be an important place for us to make money for clients, not just in China, but also South Korea and Taiwan.

What is your view of the U.S. market?

There have been so many more bargains overseas. Our Global Value fund is still underweight the U.S. versus the benchmark. The most undervalued stocks are in Europe right now.

Any advice for investors who may be feeling antsy, given the market turmoil?

Heading into the bottom of the cycle is always horrible. This is the time to use dollar-cost averaging—investing smaller amounts over a longer period—to buy the stocks you always wanted and to take advantage of others' panic, because on the other side of this is the upside. Markets tend to reflect GDP; we may be in a slowing period, but if the past is any guide to the future, we will recover and grow again.

Thanks, Sarah.

To determine if a Fund is appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's full or summary prospectus, which may be obtained by calling 1-866-947-7000. Read it carefully before investing.

Regarding Russian stocks in Causeway-managed portfolios, Causeway's international value and global value portfolios did not have any direct Russian exposures. Causeway's representative emerging markets and international opportunities portfolios did not hold stocks traded in Moscow but had three Russian exposures through holdings in depositary receipts (GDRs) listed on the London Stock Exchange (LSE). These exposures comprised approximately 2% of a representative emerging markets portfolio and 0.5% of a representative international opportunities portfolio as of February 24, 2022. Causeway sold some of these holdings until shortly before they were suspended from trading in early March, and these GDRs continue to be held in emerging markets and international opportunities accounts. Causeway is tracking developments but does not currently have visibility as to when trading may resume and brokers may begin accepting orders.