



# A Value Manager's Take on Disruption: Competitive Strength as an Alpha Factor

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Solely for the use of institutional investors and professional advisers.

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# Agenda

- Avoiding Value Traps
- Porter's Five Forces
- Causeway Competitive Strength Model
- Model Performance
- Causeway Applications

# Porter's Five Forces

- Harvard Business School professor Michael Porter created this framework to analyze an industry's competitive dynamics and likely profitability



*Note: In his 1979 Harvard Business Review article, "How Competitive Forces Shape Strategy," and subsequent 2008 article, "The Five Competitive Forces That Shape Strategy," Professor Michael Porter detailed his "five forces" framework to help analyze industry competition and determine the relative attractiveness of an industry.*

# Link Between Recent Returns and Industry Structure

*MSCI ACWI Index Top/Bottom 5 Industries Sorted by Sharpe Ratio (Last 10 Years)*

ACWI Industry	Annualized		Sharpe Ratio
	Return	Volatility	
Software	20.4%	16.6%	1.08
Internet & Direct Marketing Retail	27.5%	23.5%	1.06
Health Care Equipment & Supplies	16.0%	13.9%	0.99
Semiconductors & Semiconductor Equipment	20.7%	18.5%	0.98
IT Services	17.2%	15.8%	0.94
...	...	...	...
<i>MSCI AC World</i>	<i>9.8%</i>	<i>14.1%</i>	<i>0.53</i>
...	...	...	...
Airlines	0.3%	24.7%	(0.07)
Metals & Mining	-0.4%	26.9%	(0.09)
Independent Power and Renewable Electricity Producers	0.0%	15.1%	(0.14)
Oil Gas & Consumable Fuels	-1.5%	22.5%	(0.16)
Energy Equipment & Services	-11.3%	35.2%	(0.37)

*Note: All 69 GICS industries in the MSCI ACWI Index are sorted based on realized Sharpe Ratio from April 30, 2011 to April 30, 2021 using gross, unhedged index returns. The table above includes the industries with the highest five and lowest five Sharpe Ratios. Sharpe Ratio is a measure of risk-adjusted performance that divides the average return minus the risk-free return by the standard deviation of those excess returns (returns above the risk-free return). Sharpe Ratio calculation assumes monthly implied 10-Year U.S. Treasury yields as the risk-free return. Source: FactSet, MSCI, Causeway Analytics*

## How Can We Improve and Adapt for Stock Selection?

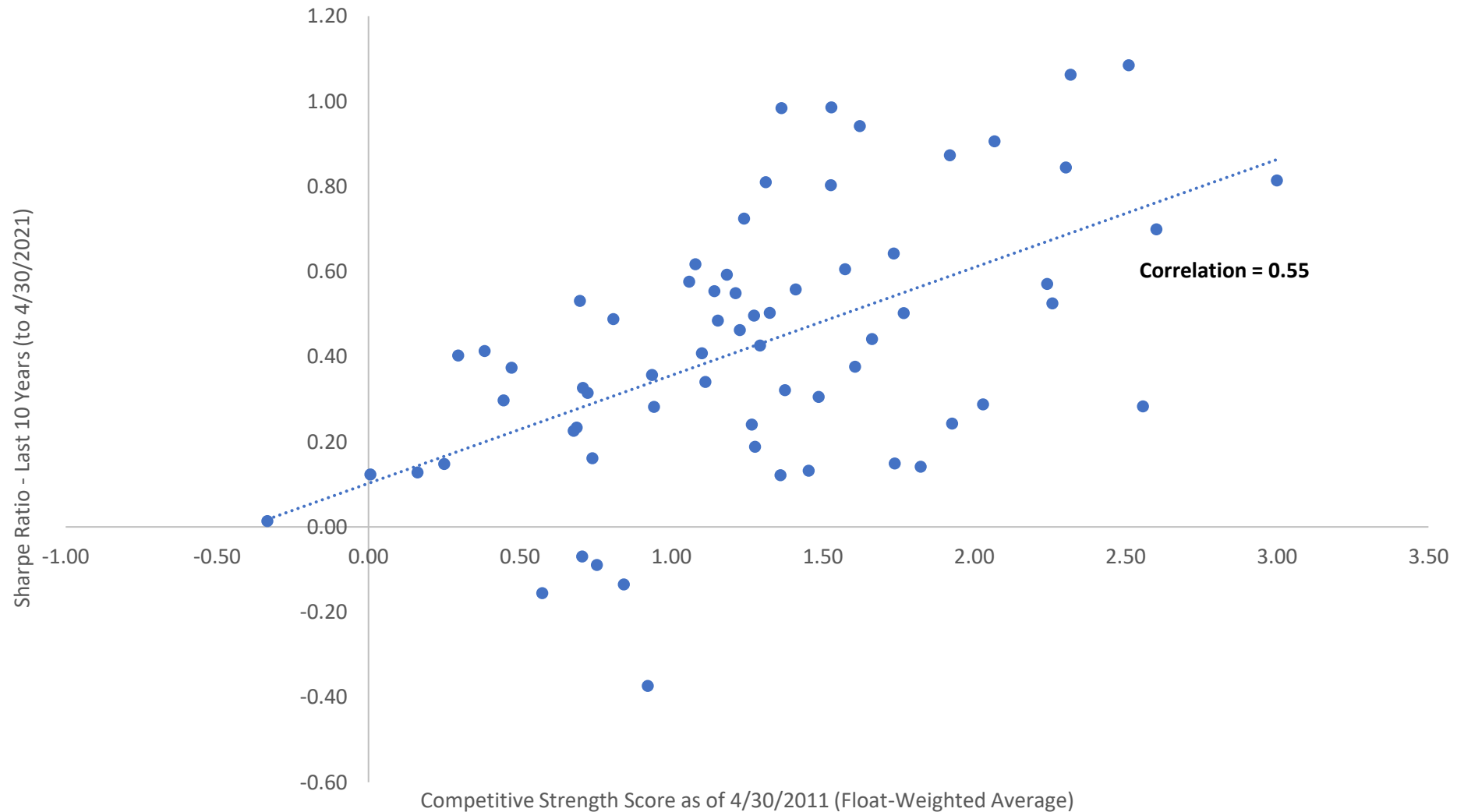
- **MAKE COMPANY-SPECIFIC:** We care about an individual company's competitive position WITHIN an industry
- **MEASURE CHANGE:** Capture changes over time to measure how well (or not) a company is embracing technological (and other forms of) change

# Competitive Strength Model

- High and improving **margins**
- Strong and improving **returns**
- Favorable **industry structure**
- High and improving **market share** with high industry concentration
- Low **balance sheet stress**

# Competitive Strength and Risk-Adjusted Industry Returns

*Correlation between an Industry's Causeway Competitive Strength Score and Subsequent Sharpe Ratio*

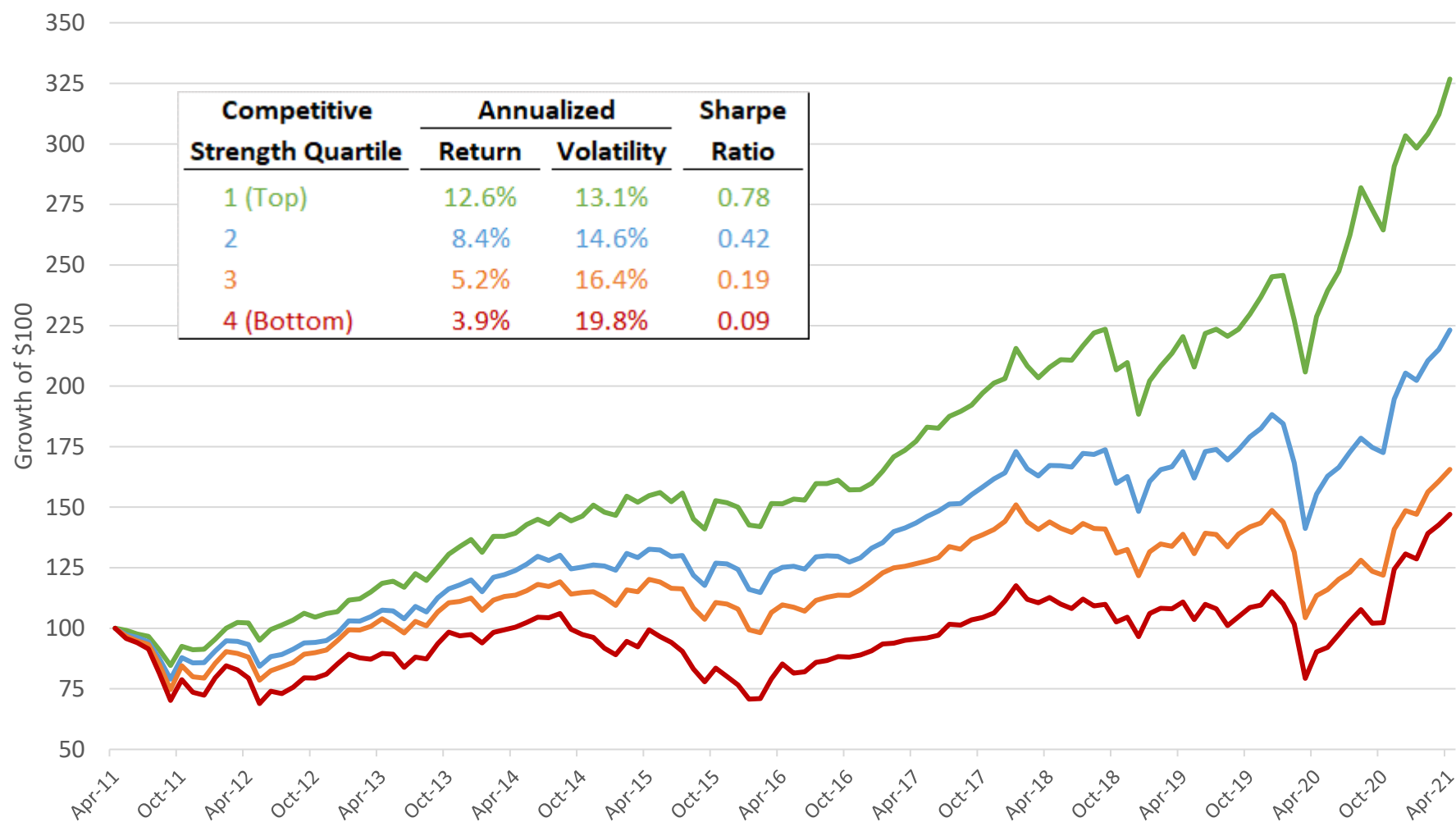


*Note: Each data point represents a GICS industry within the MSCI ACWI universe. The x-axis plots an industry's float-weighted average Causeway Competitive Strength score as of April 30, 2011, and the y-axis plots that industry's float-weighted realized Sharpe Ratio from April 30, 2011 to April 30, 2021 using gross, unhedged industry index returns. Sharpe Ratio calculation assumes monthly implied 10-Year U.S. Treasury yields as the risk-free rate. Source: Causeway Analytics, FactSet, MSCI*



# Top Quartile of Stocks Sorted by Competitive Strength Outperformed

*MSCI ACWI Index Universe Sorted by Competitive Strength Quartile*

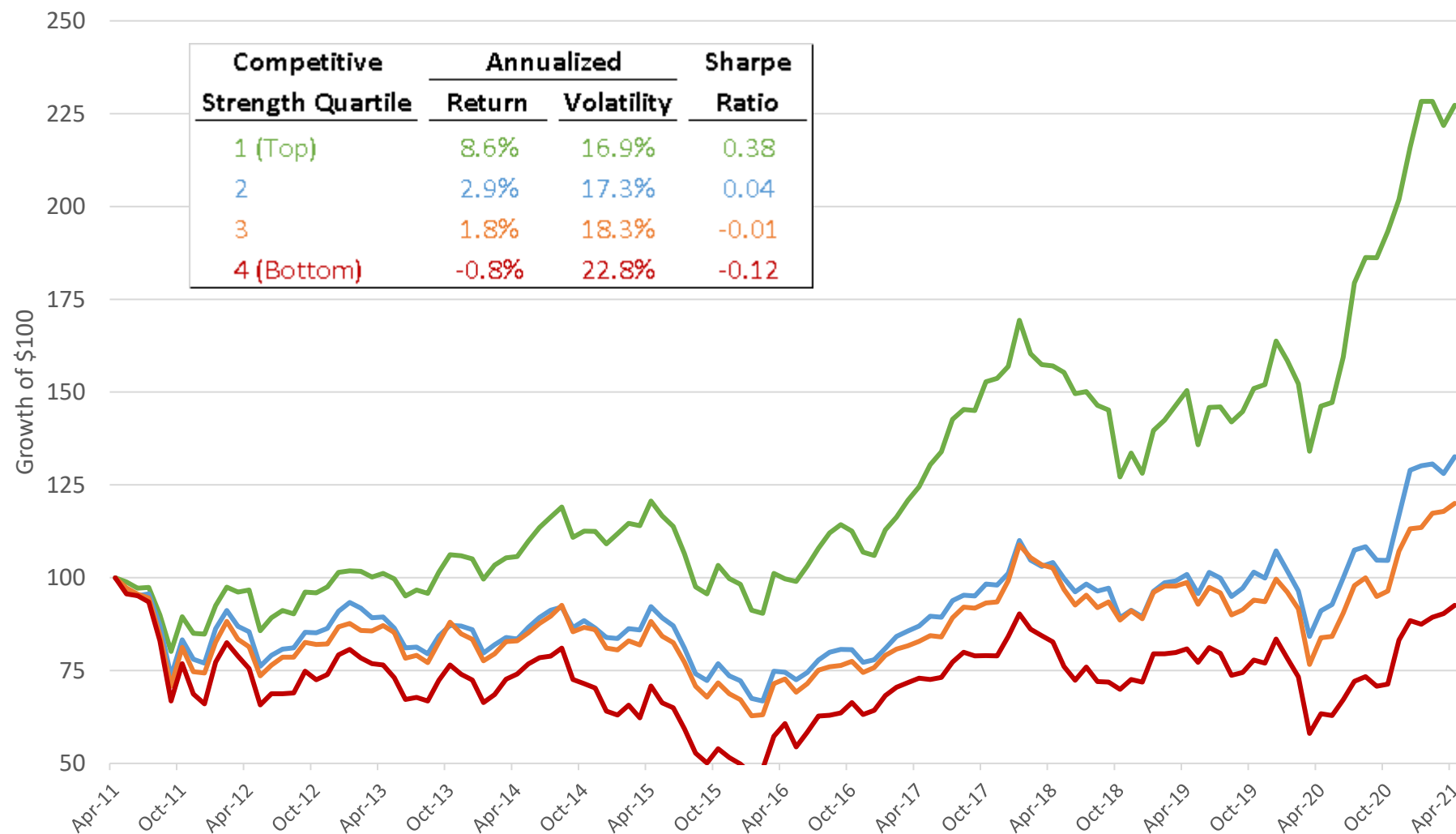


*Note: Stocks sorted into quartiles by Causeway Competitive Strength score at the end of each month beginning April 30, 2011 and float-weighted performance tracked for the following month, rebalancing monthly. Universe is the MSCI ACWI Index. Data through April 30, 2021. Sharpe Ratio calculation assumes monthly implied 10-Year U.S. Treasury yields as the risk-free return. Note that Causeway does not manage portfolios based solely on Competitive Strength scores. See disclosures at the end of this presentation for further information. Source: Causeway Analytics, FactSet, MSCI*



# Top Quartile of Stocks Sorted by Competitive Strength Outperformed

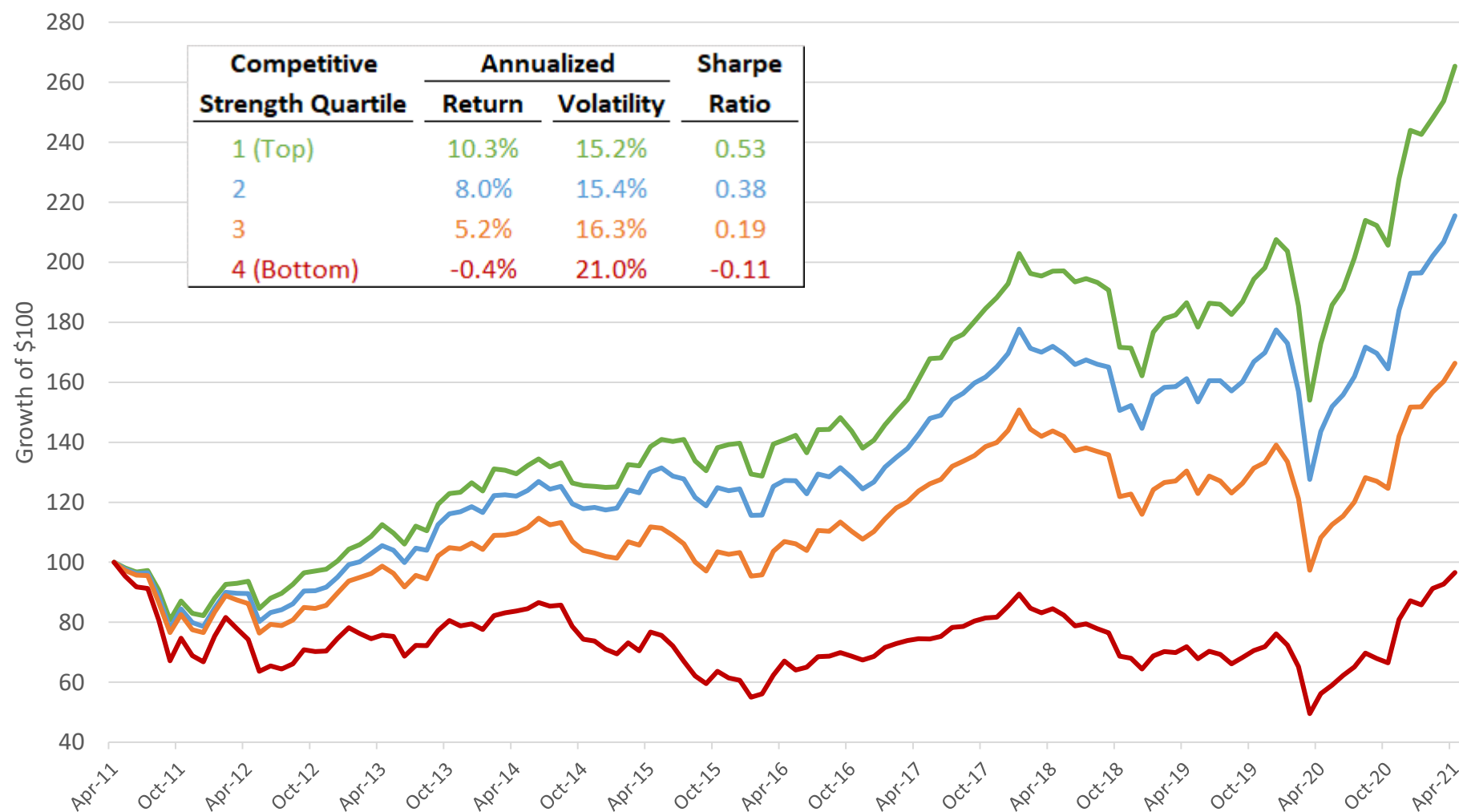
*MSCI Emerging Markets Index Universe Sorted by Competitive Strength Quartile*



*Note: Stocks sorted into quartiles by Causeway Competitive Strength score at the end of each month beginning April 30, 2011 and float-weighted performance tracked for the following month, rebalancing monthly. Universe is the MSCI Emerging Markets Index. Data through April 30, 2021. Sharpe Ratio calculation assumes monthly implied 10-Year U.S. Treasury yields as the risk-free return. Note that Causeway does not manage portfolios based solely on Competitive Strength scores. See disclosures at the end of this presentation for further information. Source: Causeway Analytics, FactSet, MSCI*

# Top Quartile of Stocks Sorted by Competitive Strength Outperformed

MSCI ACWI ex USA Small Cap Index Universe Sorted by Competitive Strength Quartile



Note: Stocks sorted into quartiles by Causeway Competitive Strength score at the end of each month beginning April 30, 2011 and float-weighted performance tracked for the following month, rebalancing monthly. Universe is the MSCI ACWI ex USA Small Cap Index. Data through April 30, 2021. Sharpe Ratio calculation assumes monthly implied 10-Year U.S. Treasury yields as the risk-free return. Note that Causeway does not manage portfolios based solely on Competitive Strength scores. See disclosures at the end of this presentation for further information. Source: Causeway Analytics, FactSet, MSCI

# Correlation with other Alpha Factor Categories

## MSCI Emerging Markets Index

	Value	Growth	Technical	Competitive Strength
Value	--			
Growth	-0.12	--		
Technical	-0.31	0.47	--	
Competitive Strength	0.02	0.08	0.14	--

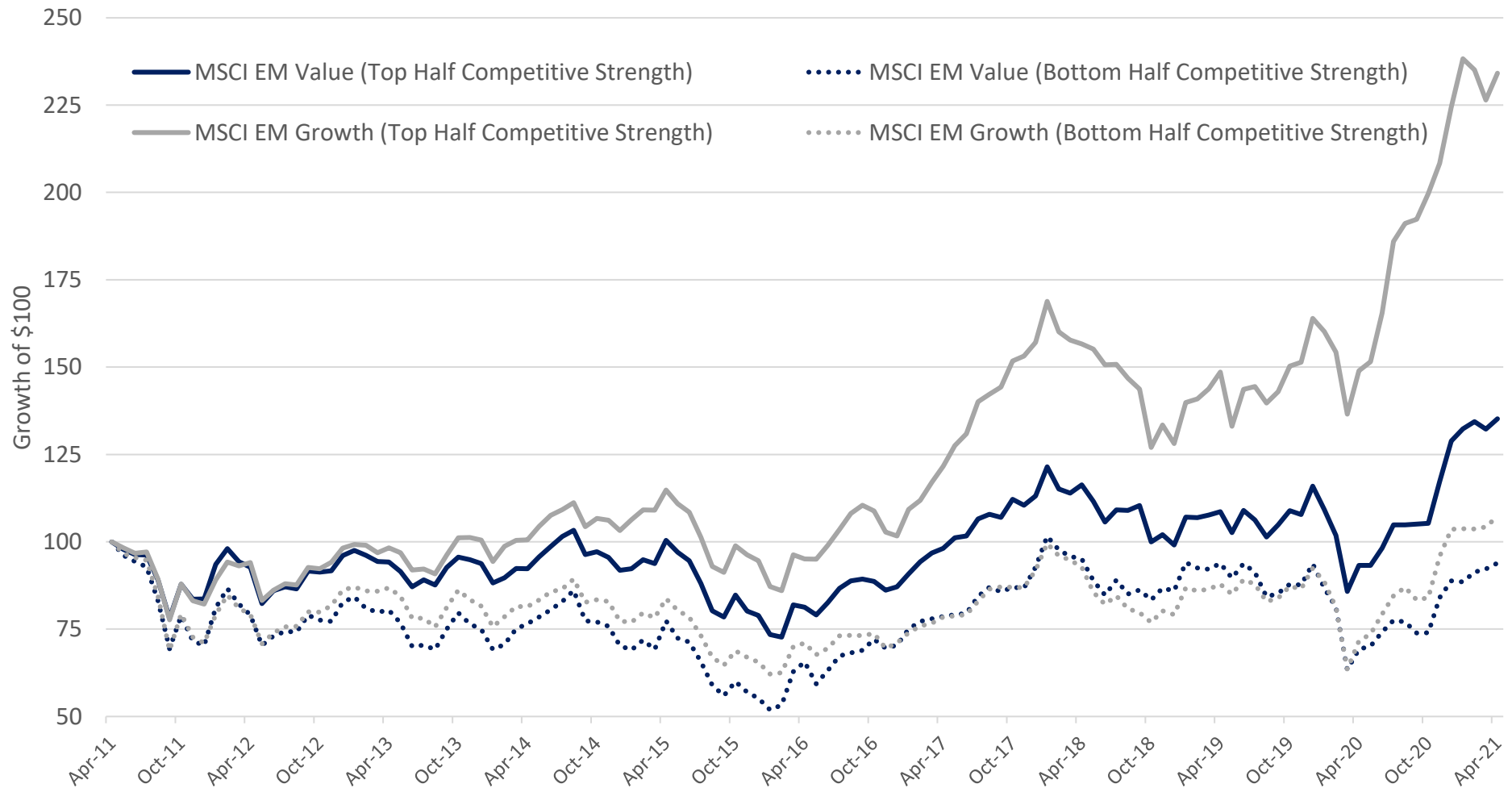
## MSCI ACWI ex USA Small Cap Index

	Value	Growth	Technical	Quality	Competitive Strength
Value	--				
Growth	-0.11	--			
Technical	-0.21	0.41	--		
Quality	0.15	0.03	0.07	--	
Competitive Strength	0.03	0.11	0.19	0.22	--

*Note: Correlation numbers represent average monthly correlations of factor scores for the 10 years ended April 30, 2021. Factor categories represent the bottom-up alpha factor categories in Causeway's Emerging Markets and International Small Cap models. "Alpha" means performance exceeding the benchmark index. See disclosures at the end of this presentation for further information. Source: Causeway Analytics*

# Value's top half of stocks sorted by Competitive Strength outperformed Growth's bottom half

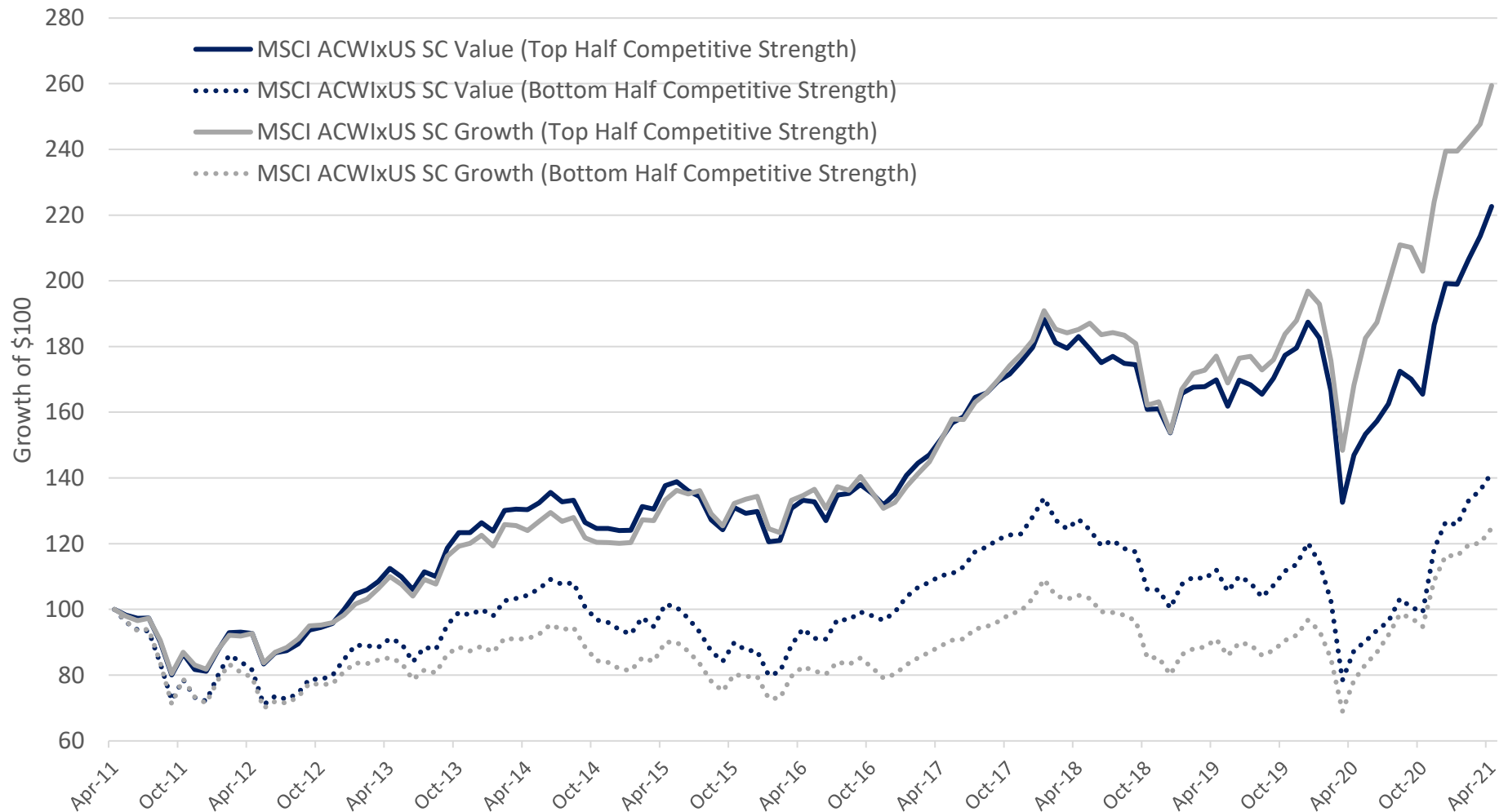
*MSCI Emerging Markets Value and Growth Indices Sorted into Halves by Competitive Strength*



*Note: Universes sorted into halves by Causeway Competitive Strength score at the end of each month beginning April 30, 2011 and float-weighted performance tracked for the following month, rebalancing monthly. Universes are the MSCI Emerging Markets Value Index/MSCI Emerging Markets Growth Index. Data through April 30, 2021. Source: Causeway Analytics, FactSet, MSCI*

# Value's top half of stocks sorted by Competitive Strength outperformed Growth's bottom half

*MSCI ACWI ex USA Small Cap Value and Growth Indices Sorted into Halves by Competitive Strength*



*Note: Universes sorted into halves by Causeway Competitive Strength score at the end of each month beginning April 30, 2011 and float-weighted performance tracked for the following month, rebalancing monthly. Universes are the MSCI ACWI ex USA Small Cap Value Index/MSCI ACWI ex USA Small Cap Growth Index. Data through April 30, 2021. Source: Causeway Analytics, FactSet, MSCI*

# Top 10 / Bottom 10 Emerging Markets Stocks Ranked by Competitive Strength

MSCI Emerging Markets Universe (5/10/2021)

Company Name	Margins	Returns	Industry Structure	Market Share	Balance Sheet Strength	Competitive Strength
TOP GLOVE CORP BHD	2.86	2.83	0.30	1.83	0.50	3.00
KWEICHOW MOUTAI	1.94	2.07	0.06	2.85	1.02	3.00
EVERGREEN MARINE C	1.96	2.83	1.30	1.44	0.61	3.00
SAUDI ARABIAN OIL	2.30	2.84	1.17	1.50	1.26	3.00
TAIWAN SEMICON MAN	1.03	1.50	1.99	1.77	1.26	2.85
SRI TRANG GLOVES	2.80	2.83	0.97	(0.03)	0.82	2.80
TENCENT HLDGS LTD	0.37	0.53	2.67	3.00	0.76	2.77
WULIANGYE YIBIN CO	1.92	1.56	(0.07)	2.85	0.91	2.71
SUPERMAX CORP	2.98	2.83	0.27	0.65	0.39	2.70
SMOORE INTL HDGS L	2.59	2.76	0.71	0.67	0.32	2.67
ABSA GROUP LTD	(0.57)	(0.47)	(1.92)	(0.95)	(2.45)	(2.40)
NEDBANK GROUP LTD	(0.56)	(0.49)	(1.92)	(0.97)	(2.45)	(2.41)
OLD MUTUAL LTD	(1.94)	(0.79)	(0.88)	(0.70)	(2.15)	(2.44)
SAUDI BRITISH BANK	(2.66)	(1.27)	(1.92)	(1.00)	0.32	(2.47)
CREDICORP LTD	(1.32)	(0.76)	(1.92)	(0.99)	(1.70)	(2.53)
SANTANDER BANK POL	(0.77)	(0.56)	(1.92)	(1.00)	(2.45)	(2.53)
ZHONGTIAN FINANCIA	(1.95)	(1.23)	(0.87)	(0.98)	(2.15)	(2.71)
TUPRAS(T PETR RAF)	(1.56)	(2.27)	(0.64)	(0.89)	(2.45)	(2.95)
YES BANK	(2.20)	(1.67)	(1.92)	(0.96)	(1.07)	(2.95)
EMAAR THE ECONOMIC	(2.82)	(2.11)	(0.87)	(0.82)	(1.61)	(3.00)

Note: Top 10 / Bottom 10 stocks in the MSCI Emerging Markets Index universe sorted by Causeway's Competitive Strength composite score. Note that Causeway does not manage portfolios based solely on Competitive Strength scores. See disclosures at the end of this presentation for further information. Source: Causeway Analytics

## Summary

- An industry's competitive landscape and a company's position within it have been closely linked to changes in profitability and, ultimately, a stock's return potential
- As assumptions about the future swiftly change to adapt to the post-COVID reality, assessing competitive strength is perhaps more important than it has ever been



## Q & A

# Appendix

# Top 10 / Bottom 10 International Small Cap Stocks Ranked by Competitive Strength

MSCI ACWI ex USA Small Cap Index (5/10/2021)

Company Name	Margins	Returns	Industry Structure	Market Share	Balance Sheet Strength	Competitive Strength
YANGMING MARINE	1.17	2.51	2.55	2.57	0.13	3.00
GIFTEE INC	2.26	1.18	1.59	1.60	0.00	3.00
INTERNATIONAL GAMES SYSTEM	2.64	2.51	1.68	0.41	0.91	3.00
ADMICOM OYJ	2.23	2.57	0.37	1.87	0.00	3.00
PLUS500 LTD	2.33	1.28	0.71	2.36	0.87	2.86
ADDCN TECHNOLOGY C	1.70	1.63	1.59	1.09	0.00	2.84
ESCORTS LIMITED	0.58	1.91	2.40	2.24	0.30	2.81
SRI TRANG AGRO IND	1.36	2.51	0.46	3.00	(0.29)	2.66
WESTWING GROUP AG	0.60	1.53	2.69	1.93	(0.03)	2.54
PR TIMES INC	1.96	2.51	0.56	1.12	0.55	2.53
EDREAMS ODIGEO	(2.71)	(2.33)	(0.36)	(0.38)	(2.32)	(3.00)
DAMAC PROPS DUBAI	(2.07)	(1.95)	(1.26)	(1.73)	(2.26)	(3.00)
BRAIT PLC	(3.00)	(2.73)	(0.55)	(1.86)	(2.81)	(3.00)
MELIA HOTELS INTL	(3.00)	(2.73)	0.34	(0.79)	(2.81)	(3.00)
CHINA ZHENG TONG AU	(2.96)	(2.73)	0.47	(1.52)	(2.81)	(3.00)
GUORUI PROPERTIES	(1.53)	(1.09)	(1.60)	(1.08)	(2.81)	(3.00)
MIRAE ASSET MAPS M			(1.86)	(1.35)		(3.00)
FLIGHT CENTRE TRAV	(3.00)	(2.73)	(0.06)	(1.66)	(0.85)	(3.00)
CARNIVAL PLC	(3.00)	(2.73)	1.63	(1.26)	(2.81)	(3.00)
RESILIENT REIT LTD	(2.56)	(2.25)	(1.50)	(0.72)	(2.81)	(3.00)

Note: Top 10 / Bottom 10 stocks in the MSCI ACWI ex USA Small Cap Index universe sorted by Causeway's Competitive Strength composite score. Note that Causeway does not manage portfolios based solely on Competitive Strength scores. See disclosures at the end of this presentation for further information. Source: Causeway Analytics

# Disclosures

*This market commentary expresses Causeway's views as of May 2021 and should not be relied on as research or investment advice regarding any stock. These views and any portfolio holdings and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass. Forecasts are subject to numerous assumptions, risks and uncertainties, which change over time, and Causeway undertakes no duty to update any such forecasts. Information and data presented has been developed internally and/or obtained from sources believed to be reliable; however, Causeway does not guarantee the accuracy, adequacy or completeness of such information.*

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*Historical information about Causeway's Competitive Strength score is derived from back-tested data using a simulated process. Causeway does not currently manage assets using this process. There are numerous inherent limitations in the use of simulated information, including that it may not reflect the impact that material economic and market factors might have had on the portfolio managers' decision making if they were actually managing accounts using that process. The simulated information does not reflect contemporaneous trading or any transaction costs. Simulated information may not be indicative of the future returns of any portfolio.*

*The Causeway Emerging Markets strategy uses quantitative factors that can be grouped into eight categories: valuation, growth, technical indicators, competitive strength, macroeconomic, country, sector, and currency. The Causeway International Small Cap strategy uses quantitative factors that can be grouped into six categories: valuation, earnings growth, technical indicators, competitive strength, macroeconomic, and country. The return attributed to a factor is the difference between the equally weighted average return of the highest ranked quintile of companies in the strategy's universe based on that factor and that of the lowest ranked quintile of companies.*

*The MSCI ACWI Index is a free float-adjusted market capitalization index, designed to measure the performance of the large and mid-cap segments across 23 Developed Markets and 26 Emerging Markets countries. The MSCI ACWI Value Index is a subset of the MSCI ACWI Index, and targets 50% coverage of the MSCI ACWI Index, with value investment style characteristics for index construction using three variables: book value to price, 12-month forward earnings to price, and dividend yield. The MSCI ACWI Growth Index is a subset of the MSCI ACWI Index and targets the remaining 50% coverage.*

*The MSCI Emerging Markets Index is a free float-adjusted market capitalization index, designed to measure equity market performance of emerging markets across 26 Emerging Markets countries. The MSCI Emerging Markets Value Index is a subset of the MSCI Emerging Markets Index, and targets 50% coverage of the MSCI Emerging Markets Index, with value investment style characteristics for index construction using three variables: book value to price, 12-month forward earnings to price, and dividend yield. The MSCI Emerging Markets Growth Index is a subset of the MSCI Emerging Markets Index and targets the remaining 50% coverage.*

*The MSCI ACWI ex USA Small Cap Index is a free float-adjusted market capitalization index, designed to measure the equity market performance of small capitalization companies across 22 Developed Markets countries (excluding the US) and 26 Emerging Markets countries. The MSCI ACWI ex USA Small Cap Value Index is a subset of the MSCI ACWI ex USA Small Cap Index, and targets 50% coverage of the MSCI ACWI ex USA Small Cap Index, with value investment style characteristics for index construction using three variables: book value to price, 12-month forward earnings to price, and dividend yield. The MSCI ACWI ex USA Small Cap Growth Index is a subset of the MSCI ACWI ex USA Small Cap Index and targets the remaining 50% coverage.*

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