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ASSET MANAGEMENT

Valuation Focus Needed in 2020

SYDNEY, 26 November, 2019 – Global equity markets in 2019 have been characterised by a late cycle rally, with extraordinary low monetary policy fueling investor demand for risk assets, most notably in momentum and growth equities, says Lazard Asset Management's Warryn Robertson today.

Mr Robertson who is a portfolio manager on Lazard's Global Equity Franchise Team says that despite this, historically low interest rates should not be a justification for soaring equity markets.

"At this point, we believe it is worth remembering that interest rates are low for a reason, Mr Robertson said. "Many equity market investors seem to be falling into the trap of thinking that interest rates are low purely for their benefit. Investors are pricing in earnings growth expectations at normal levels, such that low interest rates are seemingly the rationale for paying higher multiples for many stocks."

Mr Robertson believes this is at the heart of why so many investors are getting their company valuations wrong.

"If you lower the discount rate because bond yields are so low but maintain trend earnings, it is mathematically possible to justify some of the multiples we are seeing in global equities, most notably in the technology and consumer staples sectors. However, in the long run, a business cannot grow faster than the economy or economies in which it operates."

Mr Robertson says at some point, there will be a reckoning. "Either earnings are going to disappoint because growth is lower or over time rates have to rise. Either way, that is going to be a painful process for the most overvalued companies."

Finding opportunity in 2020 markets

From a more local perspective, Aaron Binsted, Portfolio Manager on Lazard's Australian Equity team, agrees that it is interest rates, not company fundamentals, which are driving Australian equity markets higher.

"Our concern is that the economic picture does not match with equity market valuations. We do believe that we are in the latter stages of a tech boom. Software stock valuations stand near to the highest levels seen since 2000," says Mr Binsted.

"Even the valuations of more mundane sectors look challenged. The ASX Industrials Index is trading at a 30% premium to pre-GFC boom levels at a time when earnings estimates have been falling."

The good news is that there are pockets of reasonable value in the market.

Mr Binsted says that the Lazard Australian Equity Team is seeing some value in quality resources companies with growth potential, including Rio Tinto and Woodside for example. Lazard also likes some domestic infrastructure names for their defensive earnings, and some growth stocks that have fallen out of favour, such as Domino's Pizza.

Reflecting on the year ahead for global equities, Mr Robertson agrees that there are value opportunities.

“While we are value investors and our philosophical in our approach, Global Equity Franchise is a quality focused portfolio that buys forecastable businesses at sensible valuations. Today, in contrast to the broader equity market, we can find quality business trading at multiples similar to those over the past 5-years.

“We are confident that valuation focused investors will be rewarded for their discipline as we enter a late cycle period. History shows that when these cycles reverse, they do so aggressively,” says Mr Robertson.

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About Lazard Asset Management LLC

An indirect subsidiary of Lazard Ltd (NYSE: LAZ), Lazard Asset Management (LAM) offers a range of equity, fixed income, and alternative investment products worldwide. As of September 30, 2019, LAM and affiliated asset management companies in the Lazard Group managed A$308 billion worth of client assets. For more information, please visit www.lazardassetmanagement.com. Follow LAM at @LazardAssetAU.

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