Markets

Hedge Fund Manager Says Stock Price Gap Is Opportunity of Decade

By Ksenia Galouchko
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- London-based Kairos Pegasus bets on value shares with catalyst
- Value stocks continue to underperform this year on growth woes

The stock market's near-historic gulf between the priciest and cheapest stocks creates the opportunity of a decade for investors, according to a portfolio manager at the Julius Baer Group Ltd.-controlled Kairos Investment Management Ltd.

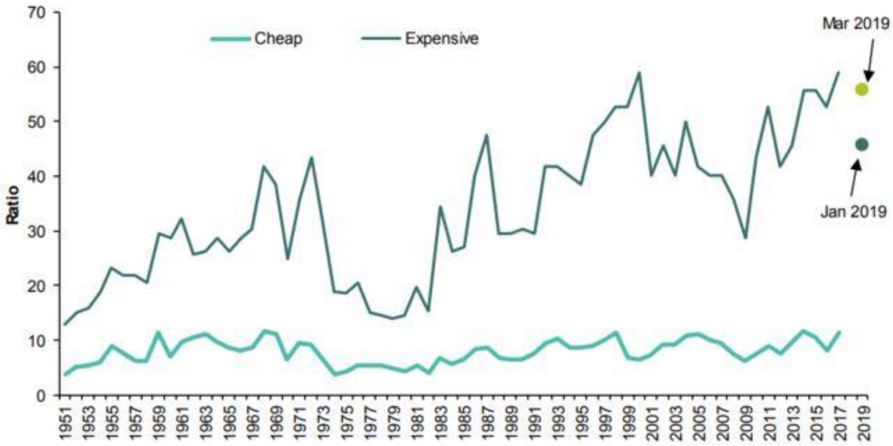
Even as this year's rally added $9 trillion to the value of global equities, outflows have continued, preventing pockets of the market from erasing December's sell-off and expanding a gap in valuations between some stocks.

Coupled with above-average earnings growth, these segments of inexpensive shares are a gold mine for investors seeking another five years of strong returns, says Federico Riggio, whose 310 million-euro ($351 million) Kairos Pegasus Fund S.A. hedge fund lists Porsche Automobil Holding SE and Volkswagen AG among its top long-term holdings.

"The market is very dislocated, it's one of the most dislocated situations in terms of relative value," London-based Riggio said by phone. "There are a lot of moving parts and that is the opportunity in a way because you can buy very high quality stocks at prices that are very, very attractive, at probably one of the most attractive entry points in some names over the last decade."

The majority of beaten-down shares offering attractive earnings growth are in the value segment, according to Riggio. In this regard, he seconds this month's contrarian call from Sanford C. Bernstein quants, who recommended value shares despite their steady underperformance every year but one since 2006.

EXHIBIT 15: **Record valuation dispersion: All of the multiple expansion is in the most expensive part of the market**



The dots show the median trailing PE ratio of the expensive quintile of the MSCI US constituents on 8th January 2019 and on 4th March 2019
Source: Ken French Data Library, Bernstein analysis

Bernstein Quants Go Rogue and Tout Decade-Losing Stock Strategy

Kairos Pegasus Fund invests in stocks with a long-short, event-driven and medium-volatility strategy, with a focus on European and some global value shares. The fund returned about 10 percent in the first two months of this year, according to its February factsheet, outpacing the HFRX Equity Hedge Index's gain of 4.7 percent in the same period.

Since its 2014 inception, the fund is up 155 percent versus the index's drop of 4.1 percent, but on a 12-month view it has lost 6.9 percent, which Riggio blames on the underperformance of value stocks: the MSCI Europe Value Index last year posted its worst drop since the 2008 financial crisis.

European equities, like global stocks, have enjoyed a robust double-digit recovery this year, but according to Bank of America Merrill Lynch's latest fund manager survey, shorting the asset class is the world's most popular trade amid concerns about economic growth.

Yet Riggio believes there's plenty more upside as both the Stoxx Europe 600 Index and MSCI Europe Value Index are trading below long-term averages on a price-to-earnings basis and have yet to regain levels seen before the fourth-quarter sell-off. The slowing economic data is also nowhere near the collapse seen during the last financial crisis, he says.

Inexpensive equities with higher dividend yields have this year continued to lag behind higher-rated peers that boast strong earnings potential, known as growth shares. Easing economic momentum doesn't bode well for value sectors that are cyclical like financials, and tends to favor those with strong cash flows such as growth companies.

In addition to Porsche and Volkswagen, Kairos Pegasus Fund's top long stock holdings in February included a Greek property investment company Grivalia Properties REIC. Porsche trades at 4 times estimated earnings, about half of the sector's average valuation, and Volkswagen at 5 times.

"You don't know if it's the bear or the bull market because you have a part of the market that's in a bear market and a part that's in a bull market," Riggio said. "I'm sure that this environment of valuation dispersion is very good for people that are aiming for a good long-term compounding."