Confidence must be earned
Amundi
ASSET MANAGEMENT

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INVESTMENT TALKS

Higher rates provide a second chance to play US value opportunities

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- ***Nowadays, US value trades at its steepest discount to growth since 1999.*** *However, declining Covid-19 cases, a broad-based economic recovery, prospects of higher interest rates as we progress out of the pandemic, and the return of persistent inflation pressures should help close the valuation gap between growth and value stocks.*
- ***The economic and financial environment is shifting in favour of value over growth****. In particular,* ***investors should avoid hyper-growth stocks with high price-to-earnings ratios****, as higher interest rates mean a higher discount rate, which lowers the net present value of future cash flows for those growth names.*
- ***Conversely, in our view, investors will have a second chance to exploit opportunities in the value space****. We believe that these will lay* ***less in the cyclical component of value stocks*** *– as was the case in the first wave of the value rebound –* ***and more in energy and financials, which should benefit from higher inflation, the upward trend for commodity prices, and a rising interest rate environment.***
- ***There are ample ESG-friendly investment opportunities among value names****. The United States currently lags other countries in adopting ESG practices. However, there is evidence that US firms are closing this gap and offer appealing opportunities to invest in* ***value companies with an ESG-improvement trajectory.***

In our Investment Talks published in October 2020, we made the case for value stocks to outperform their growth counterparts based on two key reasons:

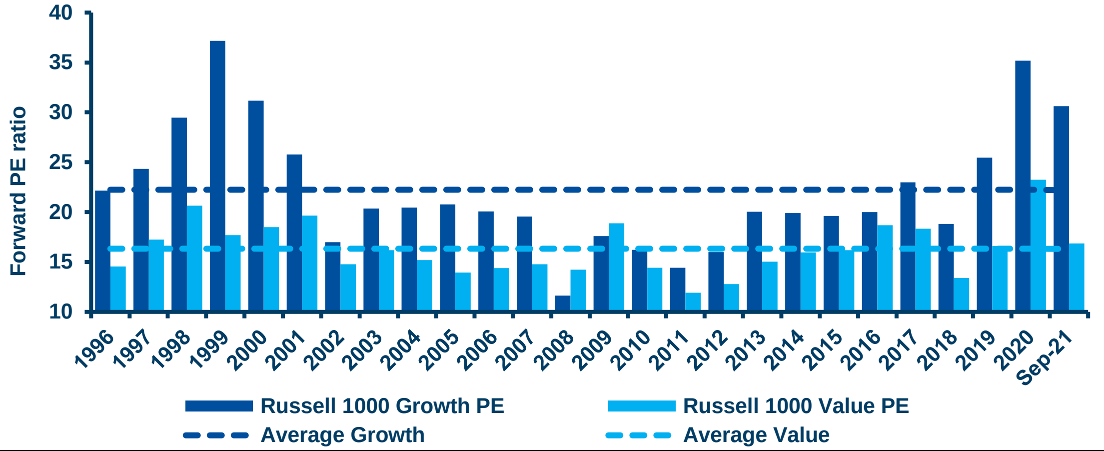
- Value was trading at a much larger-than-normal discount on forward price-to-earnings than growth.
- Unprecedented fiscal and monetary stimulus was likely to reflate the US economy, favouring value stocks given their cyclical sensitivity.

Over the period from 31 August 2020 to 30 September 2021, value has outperformed growth. The Russell 1000 Value Index (Value index) gained 28.9% versus a 19.5% gain for the Russell 1000 Growth Index (Growth index). However, between May and August 2021, growth outperformed value, as Covid-19 cases surged across the United States due to the spread of the Delta variant. **Generally, during the pandemic, growth stocks have outperformed when Covid-19 concerns have risen as many of these stocks are technology-related and benefit from a stay-at-home environment.**

Value trades at its steepest discount to growth since 1999

As shown in the following illustration, the price-to-earnings multiple for the Russell 1000 Value index was 16.8x as of 30 September 2021, compared to 30.6x for the Russell 1000 Growth index. **This 13.8 multiple point discount for value stocks is the largest since 1999.**

Value vs. growth historical valuations based on forward price to earnings



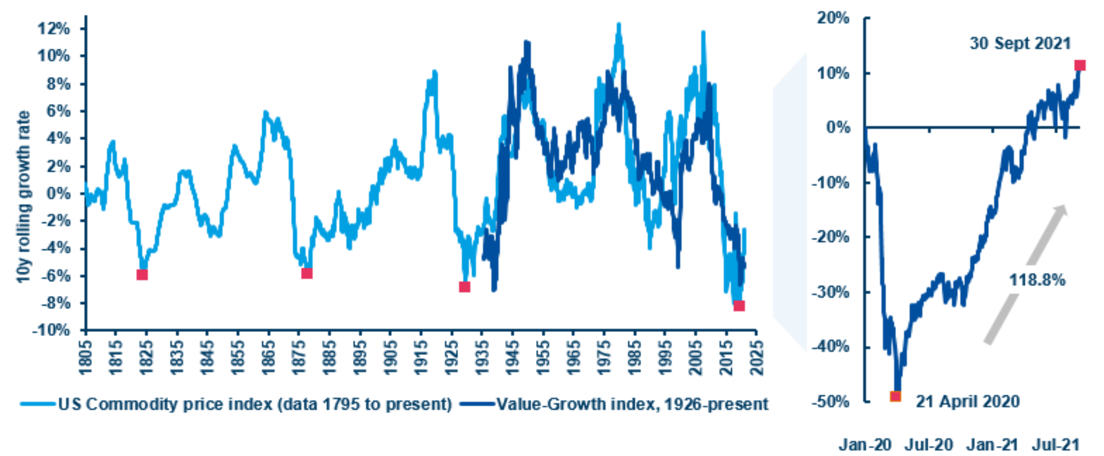
Source: Amundi, Bloomberg. Data is as of 30 September 2021. * refers to 30 September 2021. The Russell 1000® Value index measures the performance of large-cap US value stocks. The Russell 1000® Growth Index measures the performance of large-cap US growth stocks. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

"Rising commodity prices and higher inflation should support value stocks as we continue to progress out of the pandemic."

Inflation is a key indicator for value

Commodity prices are historically highly correlated to the value-to-growth index. This is because value indices tend to be more exposed to inflation-sensitive stocks than growth indices. For example, the energy, financials, industrials, and materials sectors represented 41% of the Value index as of 30 September 2021 compared with 10% for the Growth index. Since the start of the pandemic, commodity prices have risen and we expect them to remain elevated given rising demand and limited supply**. This should support value stocks as we continue to progress out of the pandemic.**

Commodity prices and value outperformance have historically been linked



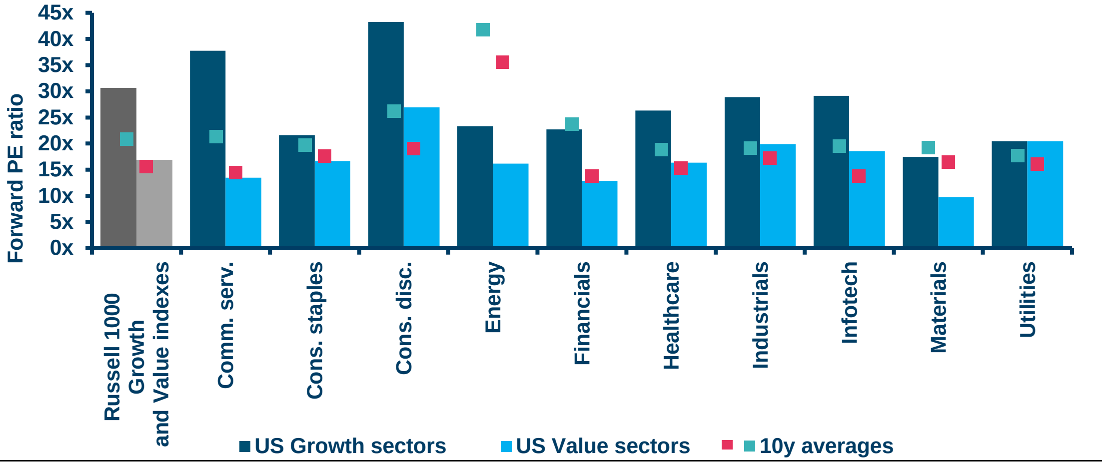
Source: Amundi, Stifel Equity Research. Data is as of 30 September 2021. Blue line represents the US commodity price Index, a weighted average of selected commodity prices. Indices used in Stifel research are: Warren & Pearson Commodity Index (1795-1912), WPI Commodities (1913-25) and equal-weighted (one-third each). PPI Energy, PPI Farm Products and PPI Metals (ferrous and non-ferrous) ex-precious metals (1926-56), Refinitiv equal weight (CCI) index (1956-94) and Refinitiv core commodity CRB Index (1994 to present). Value vs. growth links the Fama//French (Dartmouth/Tuck web-hosted) series in 1926-77 and the Russell 1000 Total Return Index, 1978 to present. The exploded version of the chart, which plots the daily total returns, is used to show the recent run in commodities. 118.8% refers to 21 April 2020 – 30 September 2021.

"We believe a growing global economy will be supportive of energy stocks as demand increases."

Energy and financials offer the most upside, in our view

A strong global economy, flush with liquidity, has resulted in the beginning of a reflationary environment, including a rise in interest rates and for commodity prices. These conditions are supportive of value sectors' profitability, particularly energy and financials. As interest rates increase, financial institutions can increase profit margins over time by lending at higher rates. In terms of the energy sector, higher commodity prices can drive revenues and earnings higher. **We believe a growing global economy will be supportive of energy stocks as demand increases.** In addition, as shown below, **valuations for energy and financials in both the Russell 1000 Growth and Value universes are at or below their ten-year averages. By comparison, most other sectors are trading above their ten-year valuation averages.** We are cautious about hyper-growth stocks with high price-to-earnings ratios, as higher interest rates mean a higher discount rate, which lowers the net present value of future cash flows for these growth names.

Wide valuation disparities relative to historical norms in selective value sectors



Source: Amundi, Bloomberg. Data is as of 30 September 2021.

Value and ESG: probably the best combination for investing in ESG improvers

Based on ESG ratings by major ratings providers, the United States currently lags other countries and regions in adopting ESG practices. However, we have found emerging evidence to suggest that US firms are closing the gap with best-in-class ESG firms globally. The lack of disclosure has been a meaningful driver of the poor relative ESG scores among US companies, but we believe that improvements in ESG data and disclosures are gaining greater traction among US companies.

In the most recent 2020 proxy season, environmental and social shareholder resolutions garnered almost as much support as governance resolutions and were double what they had been in 2018. During the first half of this year, environmental and social resolutions have seen more support than governance resolutions and the total amount of resolutions is on track to reach record highs. Importantly, the bulk of these resolutions called for greater transparency and improved disclosure by company management.

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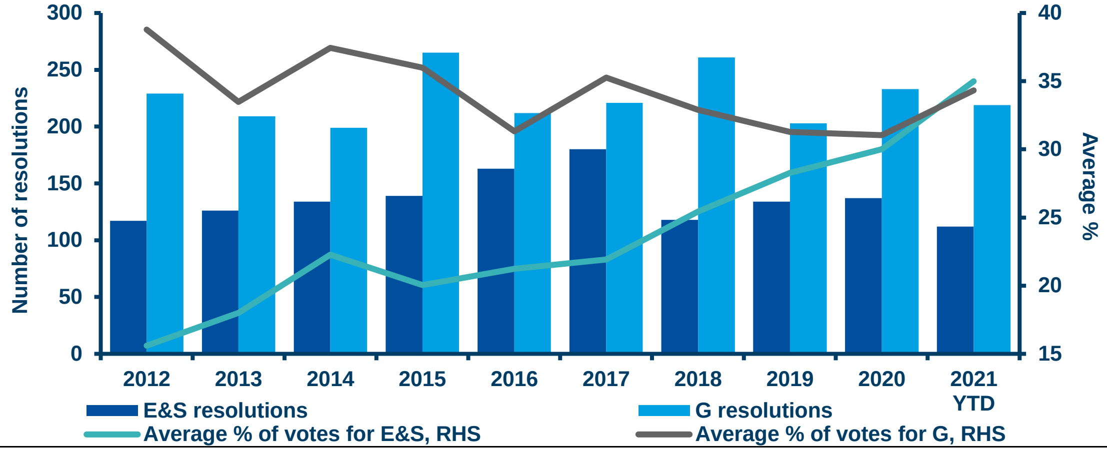
2021 shareholder resolution statistics



Source: Amundi, Goldman Sachs. Data is as of 30 June 2021.

"We expect the Federal Reserve and the Biden administration to close the regulatory disclosure gap around climate risk, which would impact ESG ratings among US financial companies."

Banks provide a clear example in this respect, as large US banks have lagged their European peers in ESG ratings, primarily due to climate risk. Financials – which account for 21% of the Value index – currently have one of the lowest ESG scores among US companies. European regulations require significant disclosure of climate risks for bank operations, such as loans, whereas the United States does not. However, we expect the Federal Reserve and the Biden administration to close the regulatory disclosure gap around climate risk, which would impact ESG ratings among US financial companies. We believe that increased disclosure and efforts to improve ESG practices among the large US banks will be a tailwind for shareholder returns and ESG ratings as the risk profile of US banks improves.

Meanwhile, energy is a sector that many ESG-minded investors avoid. However, a number of energy companies are shifting towards alternative energy and are becoming more efficient in their carbon-related energy production, which will remain the foundation of US and global energy production for some time. For example, one of the leading oil field services companies has started a carbon capture business, which removes carbon from the air and injects it into the ground. Not all energy companies are making this shift, but we believe **careful stock selection can lead to superior returns in companies that are contributing to a better environment.**

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The Amundi Investment Insights Unit (AIIU) aims to transform our CIO expertise, and Amundi's overall investment knowledge, into actionable insights and tools tailored around investor needs. In a world where investors are exposed to information from multiple sources we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.

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Definitions

- **Basis points:** One basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Growth style:** It aims at investing in the growth potential of a company. It is defined by five variables: 1. long-term forward EPS growth rate; 2. short-term forward EPS growth rate; 3. current internal growth rate; 4. long-term historical EPS growth trend; and 5. long-term historical sales per share growth trend. Sectors with a dominance of growth style: consumer staples, healthcare, IT.
- **P/E ratio:** The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS).
- **Quality investing**: It aims at capturing the performance of quality growth stocks by identifying stocks with high return on equity (ROE), stable year-over- year earnings growth, and low financial leverage.
- **Russell 1000 growth index:** it measures the performance of large cap US growth stocks.
- **Russell 1000 value Index:** it measures the performance of large cap US value stocks.
- **Value style:** It refers to purchasing stocks at relatively low prices, as indicated by low price-to- earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.

Important Information

Date of first use: 11 October 2021.

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