Sell-off sets the scene for value-investing opportunities

By Perpetual Asset Management

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Investors had been lulled into a false sense of security in recent months, and that triggered this week's sell-off in equity markets, says James Holt, head investment specialist at Perpetual.

- Equities sell-off reflects rising US recession fears
- Don’t panic and look for quality and value

A week ago, there was a string of data of data out of the United States that came in weaker than expected, Holt explains.

The manufacturing Purchasing Managers’ Index, which shows trends in manufacturing in the US and is very closely watched, came in softer than expected. The employment component was especially weak, the worst since 2020.

“That rang a little bit of an alarm bell”, Holt says. “Then jobless claims were released, and they showed another rise to the highest levels in a year, and then the non-farm payroll data came out, and it was very weak at just 114,000.”

“Sometimes you can have data points that conflict, and people cherry pick what they want. But when all the data over a couple of days is weak, that was a source of real concern for markets.”

Investors who had been lulled into a false sense of security about the US economy avoiding a recession, had to rethink the outlook.

“Suddenly the risk of recession in the US, which had dwindled to almost zero, was back as a real possibility. This was what triggered the sell-off in equity markets,” Holt says.

When the probability of a recession changed so significantly, markets were jolted into responding, which explained the suddenness and scale of the reaction, Holt says.

Coincident with this the Bank of Japan continued on a long awaited path of normalising interest rates, raising the short term policy rate from 0 to 0.1% to 0.25%, the largest rate hike since 2007.

Whilst the overall rate hike appears small it led to fears that Japanese investors would reassess their asset allocation.

For many years investors have shunned bonds and poured money into strongly performing Japanese equities or other overseas assets with higher yields than Japanese debt, the so called “carry trade”.

Concerns that this could suddenly unwind led to a stampede out of Japanese shares.

Wall Street v ASX

There is a significant difference between the US market and the Australian market, Holt says.

“Valuation wise, the Australian market is not as expensive as Wall Street and Australia tends to be a “low beta” market. It’s a lower risk market compared to the US.

“Add into that some very expensive tech names and the US is trading at a premium to the Australian market.”

It suggests that Wall Street is likely to be more volatile than the local market.

Holt says an apt comparison might be 2000-2001, during the technology stock sell-off.

“Australia came through that pretty well because it benefited from the fact that the tech bust triggered a global rotation towards resources. Back then China was emerging as a global economic powerhouse, but even today you might get some rotation towards resources which have underperformed tech for years.”

Opportunity in the selling

So what does the current volatility in markets mean for investors?

“It is an opportunity to pick up some bargains. If people do panic and throw out some high quality companies at reasonable prices, then that presents an alpha opportunity.”

Holt says Perpetual’s funds are well balanced between quality and value so are weathering the storm well.

“Also we have elevated levels of cash so there could be opportunities to deploy that.”

James Holt is head investment specialist with Perpetual’s Aussie equities team.

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