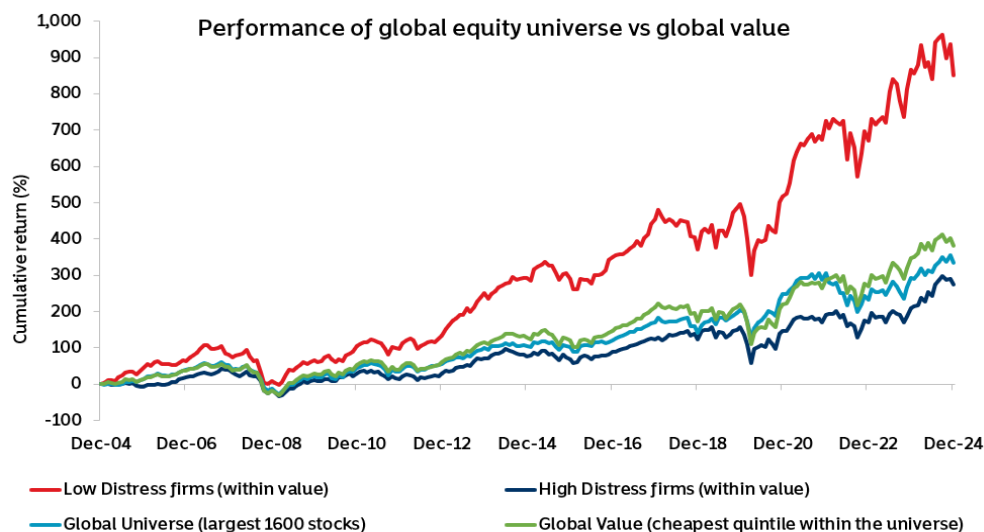


## Is cheap always cheerful?

Stephen Nguyen, CFA, Portfolio Strategist

### Chart of the Week



### What this chart shows

Much has been said regarding the rewards of Value investing, essentially buying securities at discount to their intrinsic value. Over the longer term, this strategy has proven to be successful. There are many ways investors can do this, but typically it involves buying securities that are cheap based on certain metrics such as Price to Book (PB) or Price to Earnings (PE) ratios.

However, it is also widely accepted that investing in this space carries significant risks, and certain risks are worth avoiding. In this chart, we show a basket of global value stocks, defined as the cheapest quintile based on their price to book ratio. We then rank this cohort of stocks by their level of financial distress using a broad-based indicator, namely the Altman Z-score. This is a numerical measure that aims to calculate the probability of a business going bankrupt, making it a useful gauge of the state of financial distress in the firm.

The chart illustrates that investing in the cheapest quintile of securities has historically paid off over the long term, with global value outperforming the broader global universe. However, taking on additional risk by purchasing securities with higher distress risks is not well rewarded, as they tend to underperform. Therefore, if one's portfolio is skewed towards more distressed names, its performance is likely to be mediocre over time.

### Why this is important

We often hear the term "value trap" and questions like "does value still work?". This analysis demonstrates that, while the value premium over the long term is positive, investors are more likely to be adequately compensated if they avoid the riskiest areas, which typically have a much higher risk of bankruptcy.

This also highlights the risk of accessing value stocks passively through funds and/or Exchange Traded Funds (ETFs), which tend to invest indiscriminately across the whole spectrum of cheaply traded securities, including those with higher levels of financial distress. The key takeaway is that investing in value stocks does not come without risk. We believe the best way to capture the value premium is via third-party active managers who have the required skills and expertise to carefully navigate these risks. Such managers can potentially enhance returns significantly by identifying businesses that are undervalued but exhibit lower financial distress, minimizing the risks inherent in this space.



# Global Matters Weekly

27 January 2025

For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited  
研富投資服務有限公司  
9th Floor, Centre Mark II  
305-313 Queen's Road Central  
Sheung Wan, Hong Kong

Tel +852 2827 1199  
Fax +852 2827 0270  
belvest@bis.hk  
[www.bis.hk](http://www.bis.hk)

## Important notes

This communication is issued by Belvest Investment Services Limited and/or Belvest related companies (collectively, and individually Belvest) solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of Belvest. Opinions or views of any Belvest company expressed in this communication may differ from those of other departments or companies within Belvest, including any opinions or views expressed in any research issued by Belvest. Belvest may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. Belvest has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advise to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by Belvest.

No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or return (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by Belvest are not the only ones that might reasonably have been selected and therefor Belvest does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of Belvest, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. Belvest therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communication carried within the Belvest system may be monitored.