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The Tide is Turning

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The tide is finally turning in favour of value stocks, as markets come to realize the importance of reliable cash flows rather than paying a significant premium for big promises in the future.

	Level
Euro Stoxx 50	4,086.58
S&P 500	4,500.53
Nikkei 225	27,439.99
WTI Crude	92.31
Natural Gas	4.57
Spot Gold	1,808.28

Data as of 04.02.2022

January was indeed a bad start of the year for markets. Both S&P500 and MSCI Europe were down -5.26% and -3.2%, respectively, and market volatility increased, where the VIX index reached its highest level in more than one year, as markets traded in anticipation of a more hawkish Fed reaction to address the persistent inflation problem.

Last year, rising raw material prices, wages, and supply chain issues coupled with strong demand resulted in very high and persistent inflation figures. The rising inflation forced the Fed to act by ditching the transitionary inflation narrative, tapering faster, and recently taking an even more hawkish stand by preparing to raise interest rate in March while refusing to rule out a string of aggressive rate rises at every meeting this year.

The world has been living too long in an abnormally low-interest-rate environment, where future cash flows are valued basically the same as present cash flows. January clearly showcased the inherent risk of buying growth at any price, which has been downplayed for a while, driven by the abnormally low-interest-rate environment. At the moment, with the expected rise in interest rates, the first victims will be the extremely high flyer stocks whose value is driven mainly by the expected future cash flows. As interest rate increases, these future cash flows will be valued lower than they already are. We can already observe this by comparing the January total return figures of MSCI Europe Value (+2.69) vs. MSCI Europe Growth (-8.93%).

The tide is finally turning in favour of value stocks, which were written off for more than a decade, as markets come to realize the importance of reliable cash flows now, rather than paying a significant premium for big promises in the future.

We believe that the value rotation trend will continue on the back of higher interest rates. One of the big winners will be the European equities due to their big share of value and cyclical stocks and their lower exposure to expensive stocks valued at future growth expectations.