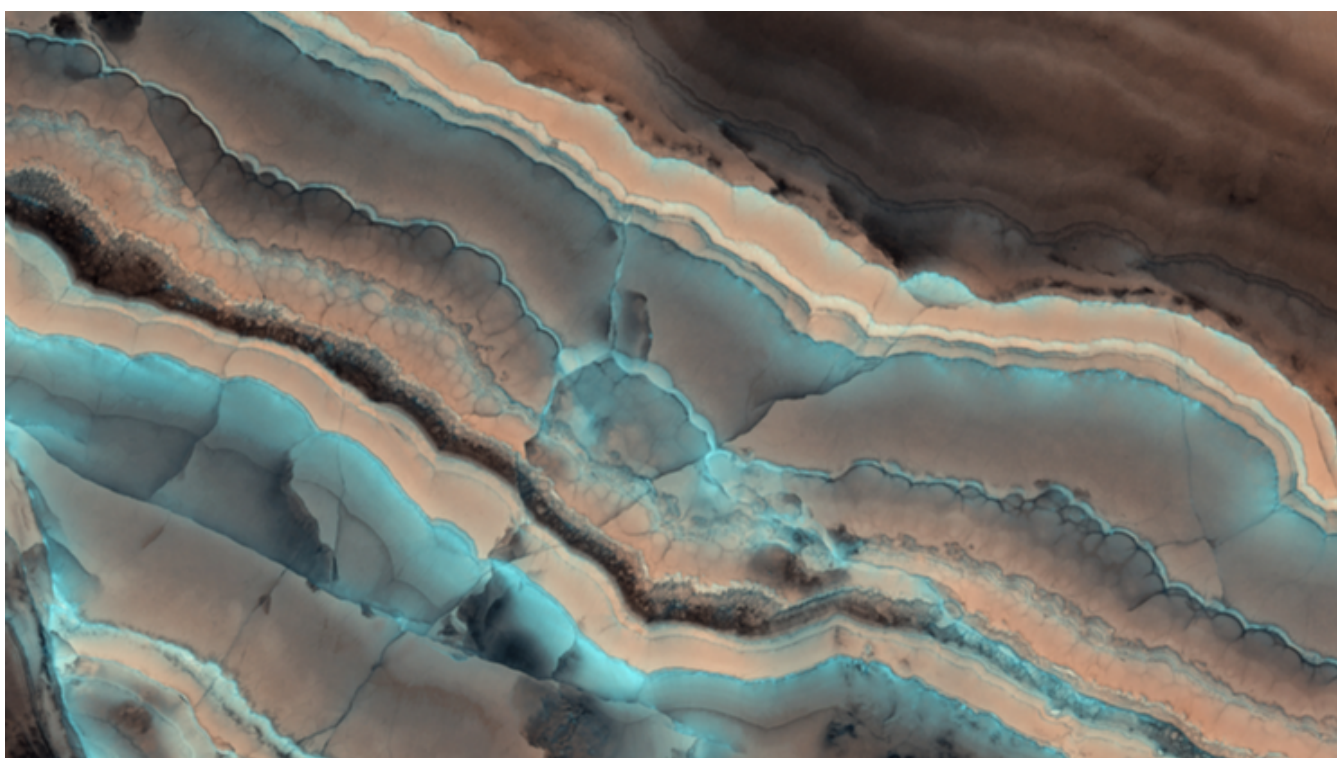


# Spotting the gaps and value traps

**By Anthony Aboud**

18 August 2021



As a fundamental value manager, one way we can add value is avoiding stocks which look cosmetically cheap but are in fact value traps. A few value-style companies raised red flags in FY21 and, as a result, we were short or did not own them.

As a value manager, generating alpha from being maximum underweight in a company like CSL Limited (ASX: CSL) when it underperforms should be a given. No value manager can look at you

with a straight face and tell you that buying a specialist pharmaceutical company at 40x + P/E (double its overseas equivalent companies) is a value investment. We have been maximum underweight CSL as we are value managers and no matter what way we look at the valuation, we have been of the view and continue to believe that CSL is overvalued.

Generating alpha from not owning CSL when it underperforms is pleasing given the alpha which it has detracted on the way up, however, this should be a given and hence we don't take credit for that.

As a fundamental value manager where we think we can add value is avoiding some stocks which cosmetically look cheap but are in fact value traps. The fund was short or did not own AGL, AMP, Aurizon, Coles, Lend Lease, Cimic, Amcor, IAG and QBE for most of this year. These are all traditional value-style companies, and all underperformed the market materially. We spent a lot of time analysing these companies and, for one reason or another, felt that while cosmetically cheap, a lot of them were value traps. Take AGL: in our heads the red flag came when they revealed they were looking to buy Vocus and then quickly back peddled when shareholders revolted. This revealed two things. First, that the company could see a weak operating environment in its core business and a need to diversify. Secondly, given the speed of the back pedal, it also showed a weak management team and board. For us, it was hard to be anything but negative wholesale electricity prices given the amount of renewable energy under construction.

On top of this, there is consistent regulatory risk as governments want to keep retail electricity prices low and phase in renewable energy as quickly as possible. AGL is the meat in this regulatory sandwich. Until the government works out that they need reliable base load generation and if the market price is forcing generator closures, the government will need to motivate the coal and gas fired generators to stay open. Until this happens, there will continue to be regulatory headwinds for AGL.

As we head into the new financial year, we feel really excited by the stocks and exposures we have in both the long and short book and believe we can generate significant alpha on both sides of the book. Picking the macro trends from here is incredibly difficult and if FY21 has taught us anything it is to keep an open mind. We consistently stress test the portfolio against various macro scenarios to understand where our exposures may be and discuss if we are happy with these exposures. While we will continue to do this, the core of our investment decisions will remain our fundamental bottom-up stock picking.

[Read the full newsletter.](#)

## Find out more about Perpetual's [SHARE-PLUS Long - Short Fund](#).

This information has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

The information is believed to be accurate at the time of compilation and is provided in good faith. This document may contain information contributed by third parties. PIML does not warrant the accuracy or completeness of any information contributed by a third party. Any views expressed in this document are opinions of the author at the time of writing and do not constitute a recommendation to act. Any views expressed in this document are opinions of the author at the time of writing and do not constitute a recommendation to act. This information, including any assumptions and conclusions is not intended to be a comprehensive statement of relevant practise or law that is often complex and can change.

The product disclosure statement (PDS) for the relevant Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS and Target Market Determination can be obtained by calling 1800 022 033 or visiting our website [www.perpetual.com.au](http://www.perpetual.com.au). No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.