Perpetual Equity Investment Company Limited

Vince Pezzullo: Ignore the noise, stay focused on value

By Vince Pezzullo

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The best investors look past daily headlines on rates, inflation, geopolitics and stock market volatility to stay focused on long-term goals. Perpetual's Head of Equities VINCE PEZZULLO explains why.

- Low correlation between GDP growth and equity returns
- Valuation more important
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MACRO-economic noise, geopolitical risk and market volatility should not deter investors from sticking to their long-term goals, says Perpetual's head of equities Vince Pezzullo.

The first months of 2024 are shaping as an uncertain time for the global economy, with debate about the future of monetary policy, questions over the outlook for economic growth and geopolitical uncertainty in the Middle East, Europe and Asia.

But becoming too focused on external events can distract from the main game of finding quality investments, says Pezzullo, highlighting a lack of correlation between equity returns and GDP growth.

"The correlation between equity returns and GDP growth is very low, approximately zero," says Pezzullo.

"That's one of the reasons stock-pickers tend not to get too worried about the macro stuff.

"Instead, what's most correlated to equity returns is valuation.

"So, when you're trying to outperform, you've just constantly got to find those investments that are relatively good value compared to the market.

"All the macro noise and exogenous events will impact the share prices day to day, but you've just got to consistently reallocate capital into companies that are undervalued relative to their prospects."

Rate cut path in question

The challenge for investors trying to take a macro-approach to markets in 2024 is that much of the data is in conflict.

"On the one hand, you've got some data that's phenomenal," says Pezzullo. "Manufacturing investment in the US is off the charts in the last year or so because of the Inflation Reduction Act and the CHIPS Act.

"That's boosting the economy. Jobs data has been relatively good and retail sales have taken off in the US.

"But on the other hand, you've also got some bearish data points. Commercial bank lending has gone negative for the first time since the GFC.



“So, people are trying to get their heads around what it means for how quickly the Fed cuts.”

The upshot for investors is not to let a focus on macro-economic data distract from the long-term game of investing, says Pezzullo.

“It's easy to get thrown off your game. Being aware of macro is not a problem — becoming obsessed with it or allowing it to interfere with stock picking can be a real problem.”

US pivot on rates

The rapid run-up in markets over the past few months is a direct result of the US Fed’s pivot on interest rates, argues Pezzullo.

“The Fed’s pivot is an effective loosening of financial conditions — even without an actual rate cut,” he says.

“Economics is no longer just goods and services and wages and so forth. It's also about how financial assets contribute to conditions as well.

“When the stock market goes up sharply, it loosens financial conditions because it's easier for businesses to get finance.

“The irony is that loosening financial conditions by announcing a pivot and sending the stock market up sharply is the equivalent of a couple of rate cuts — having talked about rate cuts,

they almost became a self-fulfilling prophecy."

That's why in recent weeks the Fed has tried to calm down expectations of immediate rate cuts, triggering volatility in equity markets.

"Powell tried to hose it down a bit and that's why markets have been quite volatile. We had very strong growth in November and December, and then gave back a bit at the start of this year."

Long-term themes still in play

Pezzullo says big long-term themes like the energy transition and the shift to green metals will endure beyond temporary economic uncertainty.

"We think there's a lot there's more long-term equity returns for shareholders ahead."

Indeed, short term volatility creates the opportunity to invest at reasonable valuations.

Understanding geopolitical threats

Alongside macro-economic uncertainty, there's also no shortage of potential geopolitical threats on the horizon that could move markets, says Pezzullo.

"Geopolitics is so unpredictable — it could be any of several things: the Middle East, Ukraine, the Asia Pacific. You can't predict these things but the fact that there's three potential powder kegs raises the risks."

The solution? Stay the course, says Pezzullo.

"There's just so much that you could worry all the time. We're not going to invest around these sorts of quarterly or month-to-month changes.

"It's just a distraction that we try to screen out and focus on long-term value instead."

About Vince Pezzullo and Perpetual Equity Investment Company (ASX:PIC)

Vince is Perpetual's head of equities and portfolio manager of Perpetual Equity Investment Company (ASX:PIC).

Vince has more than 20 years of experience in financial services including global experience as an analyst and portfolio manager.

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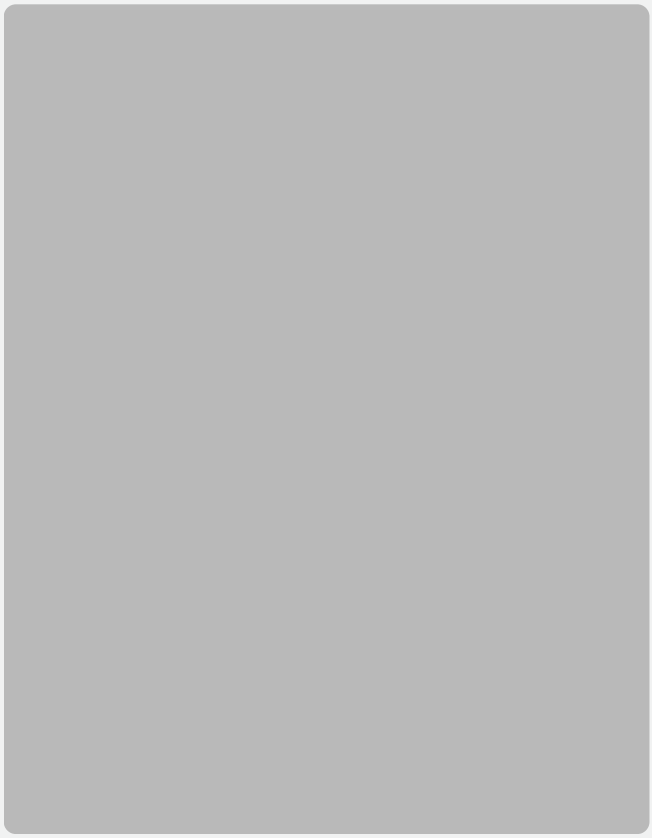
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We have a track record of contributing value through “active ownership” and deep research.

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