

OUR TWO CENTS



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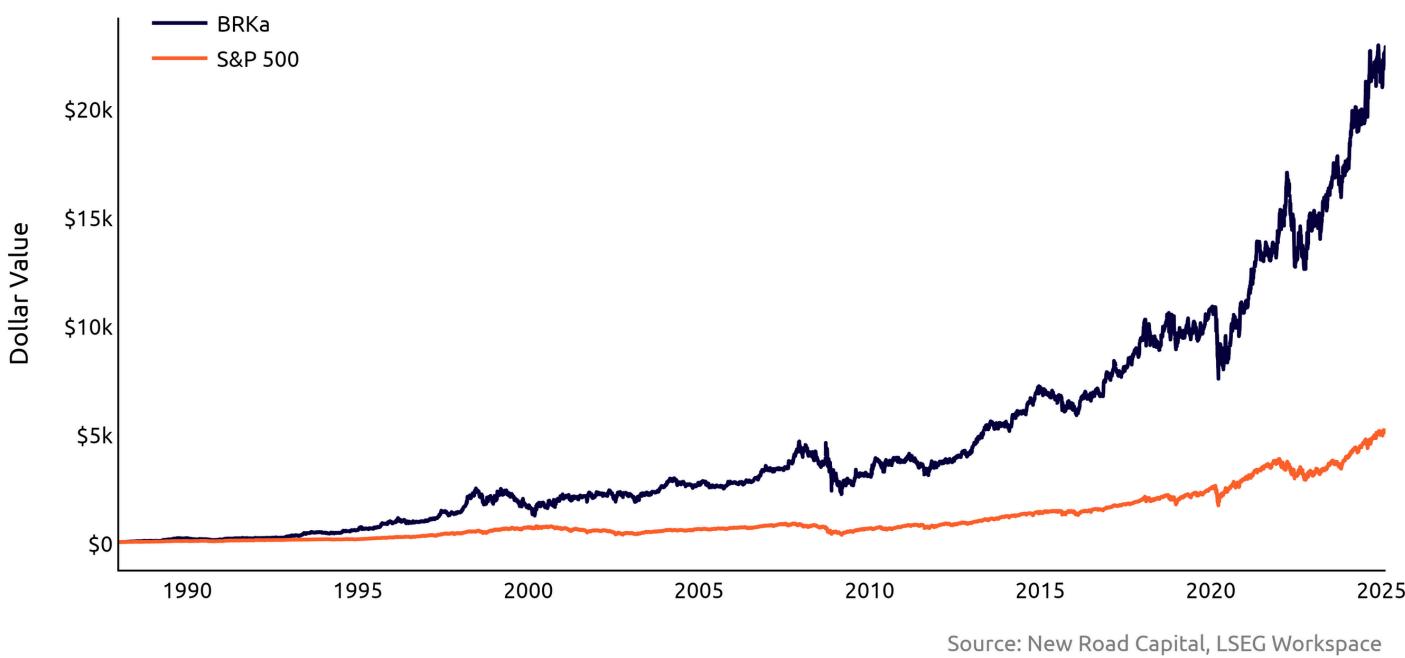


The Value of Value Investing

Value investing, made famous by legendary investors like Benjamin Graham and Warren Buffett, is based on a simple yet powerful idea: buying stocks that are undervalued should lead to better returns over time. However, value investing is not as simple as it seems. With thousands of stocks in the market, identifying true bargains requires a deep understanding of both individual companies and the broader industries they operate in. This is why active managers should be able to charge clients for the use of their insights when investing.

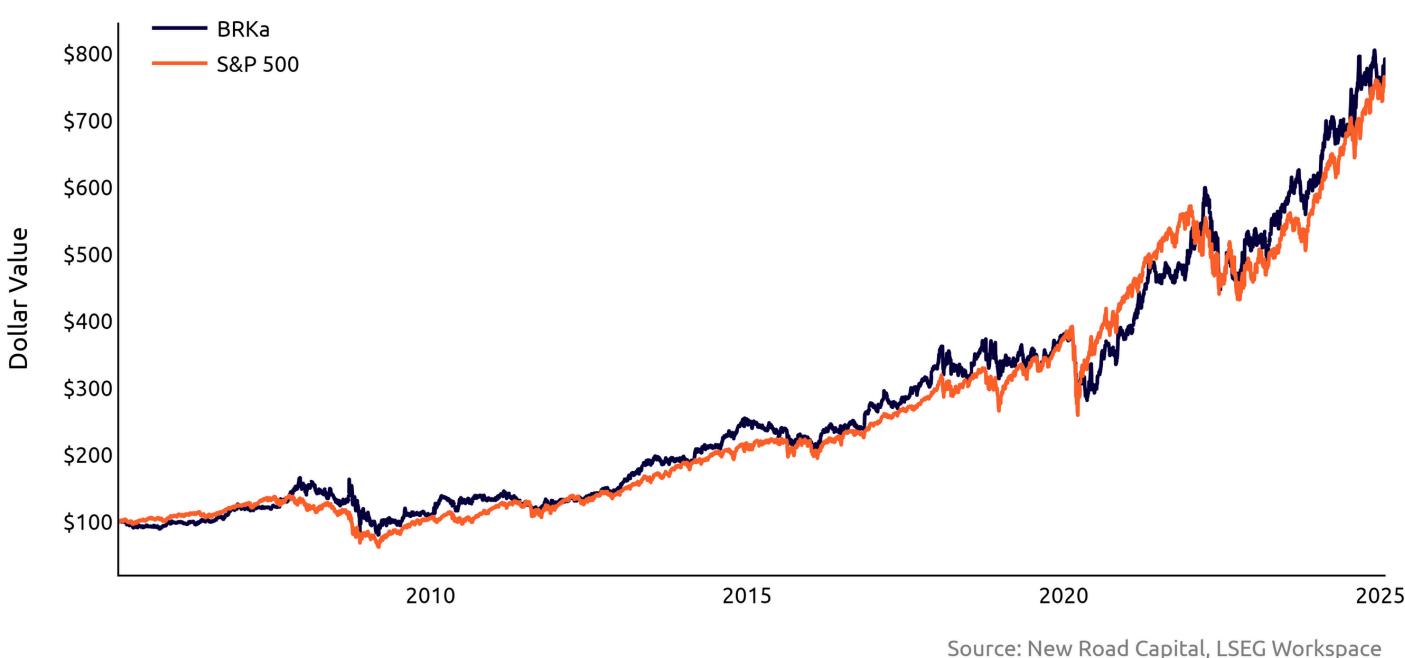
Value investing sounds compelling in theory, but has it delivered superior returns historically? The following graph shows the total return of an investment made at the start of 1988 in the S&P 500 compared to Warren Buffett's famous Berkshire Hathaway (BRK). This outperformance explains why Warren Buffett is known as "The Oracle of Omaha." Over this period, the S&P 500 returned an average of 11.3% per year, while Berkshire Hathaway delivered an impressive 15.9% annually. Although the yearly excess return does not sound spectacular, it can clearly be seen how this effect adds up over time through the effect of compounding as the total return at the end of the period is 17580% greater for BRK than for the S&P 500.

\$100 Invested in Berkshire Hathaway vs S&P 500 (From 1988)



Given the tremendous track record, it seems like a no-brainer to give your money to Warren Buffett and his team rather than putting it away in a simple index tracker. However, the story changes when only the performance of the last 20 years is considered, as depicted below. Although BRK did outperform the index over this period, it is only by the slightest margin of 0.19% per year. These return figures make the decision to invest in BRK much less clear.

\$100 Invested in Berkshire Hathaway vs S&P 500 (Last 20Y)



Another thing that value investing is famous for is to force a more conservative investment approach, so perhaps BRK's investments offered greater protection than the index? Unfortunately, since the inception of BRK, its volatility has been much higher than the S&P 500 at 27.3% versus 21.6%, respectively. Similarly, the average drawdown of BRK was -16.2% since inception, while the S&P 500 only had an average drawdown of 12.7%. What this suggests is that, over the last 20 years, Warren Buffett had no significant advantage over the rest of the market from a return or risk perspective.

The challenge with value investing today is that it is no longer a secret. Investors across the world have access to the same information, making it harder to find truly undervalued opportunities. Markets are much more efficient today than they were 30 years ago, which is where BRK banked most of its outperformance. Given today's highly efficient markets, consistently beating the index is difficult. Unless a novel approach is used, a low-cost index fund may offer the best exposure to equities without the added risk and cost of active management for most investors' portfolios.



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After graduating as a chemical engineer, Garrett pursued his master's degree in finance and investments and has passed the CFA level 3 exam. Garrett gained experience in the modelling and optimisation of financial data through his postgraduate research. As one of the newest members of the New Road Capital team, he enjoys his role as an investment analyst, where he gets to follow his passion in solving challenging problems using mathematics and technology. In his free time, Garrett never misses a Grand Prix, and has been doing Brazilian Jiu Jitsu for more than 10 years.