GMO
ASSET ALLOCATION INSIGHTS

DON'T MISS OUT

A Historic Opportunity in Deep Value Stocks

Catherine LeGraw | October 2024

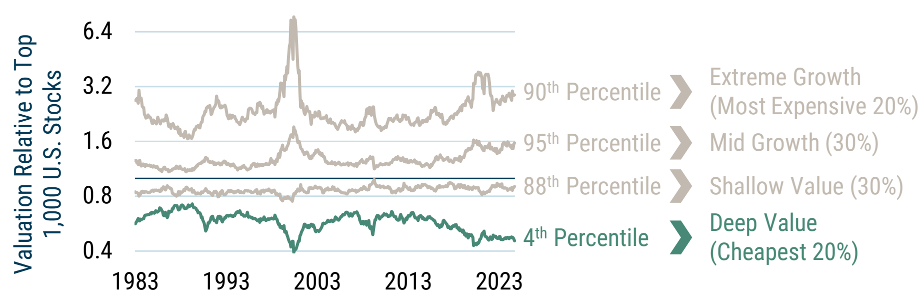
Why Value Now?

Deep value stocks are GMO Asset Allocation's highest conviction investment idea. In a world where many stocks are being driven ever higher by positive sentiment and investor optimism, some fundamentally sound but unloved companies are being left behind, consequently trading at extraordinary discounts. In both the U.S. and international equity universes, this cohort of stocks is trading at a valuation in the bottom decile of its history relative to the overall market. Quite simply, deep value is historically cheap and in our view priced to outperform dramatically in an environment where the future returns of many equity groups are saddled with expensive valuations.

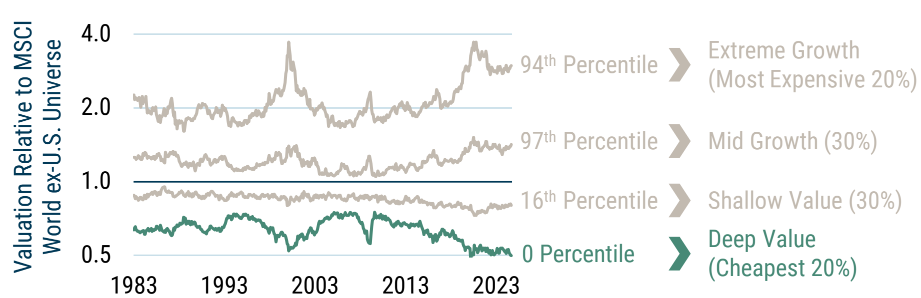
However, tapping into the value opportunity through index exposures may disappoint. Most passive approaches rely on reported book values, which in most cases don't reflect economic value, don't screen out value traps, and ignore quality and growth.

DEEP VALUE IS EXTREMELY CHEAP GLOBALLY

Valuation groups in top 1,000 U.S. Stocks



Valuation groups in MSCI World ex-U.S. Universe



As of 9/30/2024 | Source: GMO
Stock valuations are calculated on a blend of Price/Sales, Price/Gross Profit, Price/Book, and Price/Economic Book. Groups of value and market are weighted by square root of market cap. All groups have the same country exposure as the universe.
MSCI data may not be reproduced or used for any other purpose. MSCI provides no warranties, has not prepared or approved this report, and has no liability hereunder. Please visit https://www.gmo.com/americas/benchmark-disclaimers/ to review the complete benchmark disclaimer notice.

GMO Value: Three Key Improvements on Traditional Metrics

By "deep value," we simply mean stocks that are cheap, often screamingly so, relative to our appraisal of their fair value. We do not care about a "growth" or "value" label, which may have been assigned, sometimes seemingly arbitrarily, by one index provider or another. Although a low price-to-earnings or other valuation multiple can certainly correlate with cheapness, such characteristics aren't always present. Some low P/E stocks are worth even less than their prices, while some high P/E stocks warrant even bigger premiums. We target the cheapest 20% of stocks in comparison to their genuine fundamental worth, allowing for quality and potential growth while avoiding deceptively cheap, junky cyclical horrors and value traps.

GMO's approach to finding value is differentiated versus other value strategies and can add value over passive or naive exposures in a few ways:

1. **Incorporates a top-down perspective** – In addition to seeking individually mispriced stocks, we also look top-down for entire cohorts that are dislocated, such as deep value today.
2. **Builds a more realistic starting point for assessing fundamental value** – GMO has fully restated the financial statements of every company in our investment universe so that they better reflect true fundamental value. For example, we consider research & development to be an actual investment rather than simply a current expense.
3. **Develops better fundamental projections** – Our growth projections are uniquely calibrated to each company, fully accounting for that specific company's quality and growth characteristics.

Adding Value Today

If you are asking yourself how your portfolio will perform if value roars back or the U.S. market stumbles, then allocating to global value with GMO could be of interest. With GMO's newest ETFs – U.S. Value ETF (GMOV) and International Value ETF (GMOI) – you can easily tailor global value allocations.

- **Use Active to Add Value:** Investors should consider opting for active value approaches rather than index exposures. GMO value is in our view superior to naive or passive value as it assesses the true fundamental worth of companies.
- **Offset Style Drift of Other Value Managers:** It has been a tough ride for value managers over the last decade, and as a result many have moved to a more core approach in an attempt to retain assets and survive the prolonged growth cycle. GMO's value strategies are not weighed down by the baggage of past poor performance and thus remain free to truly target the very cheapest stocks.
- **Lean into Cheaper Non-U.S. Markets:** Value looks to have turned outside the U.S., so that may be the ideal place to look if you want to diversify geographical exposure away from the S&P 500. Indeed, the S&P 500 is tech and growth heavy, so an investment in international value may be the perfect complement from more than just a regional perspective.
- **Diversify U.S. Valuation Risk:** On the other hand, if you do believe that the U.S. remains exceptional but are worried about precarious valuations, then establishing a position in U.S. deep value may be an appropriate fit.

GMO has been valuation focused since our firm's founding nearly 50 years ago. With the benefit of our experience across market cycles, regardless of how you think about value in your portfolio, we advise there has rarely been a better time to invest in deep value stocks.

Catherine LeGraw
Ms. LeGraw is a member of GMO's Asset Allocation team and a partner of the firm. Prior to joining GMO in 2013, she worked as a director at BlackRock. Previously, Ms. LeGraw was an analyst at Bear, Stearns & Co. She received her BA and her BS in Economics from the University of Pennsylvania. She is a CFA charterholder.

Disclaimer

The views expressed are the views of Catherine LeGraw and the Asset Allocation team through the period ending October 2024 and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities. Past performance is no guarantee of future results.

An investor should consider the fund's investment objectives, risks, charges and expenses before investing. This and other important information can be found in the fund's prospectus. To obtain a prospectus please visit www.gmo.com. Read the prospectus carefully before investing.

Risks associated with investing in the U.S. Value ETF may include: (1) Market Risk – Equities: The market price of equities may decline due to factors affecting the issuer, its industries. or the economy and equity markets generally. Declines in stock market prices generally are likely to reduce the net asset value of the Fund's shares. (2) Management and Operational Risk: The risk that GMO's investment techniques will fail to produce desired results, including annualized returns and annualized volatility. (3) Focused Investment Risk: The Fund invests its assets in the securities of a limited number of issuers and a decline in the market price of a particular security held by the Fund may affect the Fund's performance more than if the Fund invested in the securities of a larger number of issuers. For a more complete discussion of these risks and others, please consult the Fund's Prospectus.

Risks associated with investing in the International Value ETF may include (1) Market Risk – Equities: The market price of equities may decline due to factors affecting the issuer, its industries, or the economy and equity markets generally. Declines in stock market prices generally are likely to reduce the net asset value of the Fund's shares. (2) Management and Operational Risk: The risk that GMO's investment techniques will fail to produce desired results, including annualized returns and annualized volatility. (3) Non-U.S. Investment Risk: The market prices of many non-U.S. securities (particularly of companies tied economically to emerging countries) fluctuate more than those of U.S. securities. Many non-U.S. markets (particularly emerging markets) are less stable, smaller, less liquid, and less regulated than U.S. markets, and the cost of trading in those markets often is higher than it is in U.S. markets. For a more complete discussion of these risks and others, please consult the Fund's Prospectus.

The GMO ETFs are distributed in the United States by Foreside Fund Services LLC. GMO and Foreside Fund Services LLC are not affiliated.