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SUMMARY

- We favor US Energy stocks within traditional value sectors.
- We are waiting for a stronger catalyst to unlock value in smaller banks.
- We prefer US Value themes to international ones.

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# Value Investing in the US and Beyond

## Conversation with Our Stock Selection Team, Part One

One of my favorite aspects of working at RiverFront is working with four associate portfolio managers that make up our equity selection team. This team performs analysis on individual equities that provides useful insights into how we position our portfolios. Over the next two weeks, we wanted to provide our clients with some of the insights they have uncovered.
- Adam Grossman, CFA

**Adam Grossman:**
As we have discussed in previous Weekly Views, one theme that we think will be important for 2025 is the possibility of a 'value rotation.' Dan, I know this is something you have spent time researching and quantifying; Can you walk us through what this is and why we think it could take place in 2025?

**Dan Zolet:**
Put simply 'value rotation' involves market leadership 'rotating' from growth equities to value equities. As a refresher, Table 1 illustrates how RiverFront categorizes value and growth.

**Table 1: Riverfront's Value and Growth Definition**

| Value | Growth |
|---|---|
| Energy | Technology |
| Industrials | Communication Services |
| Materials | Consumer Discretionary |
| Financials | |

The reason we think this will be a key theme in 2025 is the macroeconomic backdrop. Specifically, our expectation for moderately elevated, yet relatively stable inflation is the key. If inflation doesn't reaccelerate to the upside, the Fed will be able to continue their cutting path. Lower rates will help smaller and more cyclical companies reduce their debt burdens, as they tend to fund operations with higher cost shorter maturity debt. Additionally, inflation being elevated relative to the past decade (somewhere between 2% and 2.5%), will help drive value companies' revenue growth, in our view.

**Adam Grossman:**
That all makes sense. I know you cover the traditional cyclical sectors (Energy, Materials, and Industrials). From a selection standpoint what are you seeing in these sectors?


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**Dan Zolet:**
Across these three sectors we expect what I have just said to play out; We expect revenue to be driven by inflation and the reduction of the interest burden to fall. However, our biggest overweight relative to our benchmarks in this space is energy due to some more sector-specific reasons.

First, we estimate break-evens in the US energy patch to be around $60 per barrel. This is below our expected range for oil prices in 2025 (rangebound between $70 and $80), meaning there is room for US energy companies to generate cashflows. These can be passed on to shareholders or reinvested into the business.

One final note is how the incoming presidency will affect the US energy market. We believe that this administration's emphasis on US oil production could provide more supply to the market. However, we also believe that there will be deregulation in the space. Overall, these two factors should offset when it comes to energy companies' bottom lines, though we will keep an eye on them.

**Adam Grossman:**
Great stuff, Dan! Kaetlin, as our Financials portfolio manager, you also cover value equities. How does this 'value rotation' affect banks? Will larger banks be affected differently than regional banks?

**Kaetlin Collins:**
That's a good question, Adam! I think the big link to what Dan mentioned and the financial sector is the 'yield curve' (the difference in yield between short-term interest rates and longer-term ones). Elaborating on Dan's comments earlier, we expect the Fed to continue to cut short rates, while longer rates stay relatively more stable. The net effect of that would be a steeper yield curve. This is important because traditional banking generates profits through this differential of short and long rates, with steeper yield curves generally being more profitable for banks.

Your question about large versus small banks is also a really important one, and one I've spent a lot of time thinking about. Over the past several quarters, large banks have been able to sustain earnings without a steep yield curve through other income streams, such as trading and mergers & acquisitions advisory (M&A). Small, more regional banks have not had this luxury and have seen their stock prices suffer as a result. Because of this dynamic, it would make sense that the yield curve steepening would provide regional banks with more of a tailwind than larger banks. However, it may take more steepening to unlock the value in small banks, so we expect to be more selective as to when to enter this space.

**Dan Zolet:**
Not to turn the tables on you, but we've covered a lot of our thoughts on value in the US…but a large value asset class is international. What are our current thoughts in that space?

**Adam Grossman:**
Ah, well played! So, all things being equal, international markets should also outperform in a 'value rotation' market. Of course, like most things in life, all things are not equal here, in our view.

For starters, international economic growth has been weaker, and inflation stickier than in the US. While we aren't ready to hit the 'Stagflation' button yet, things are certainly not rosy abroad. From this weaker position, it seems likely that tariffs will be placed on a lot of international markets by the incoming administration, creating an even weaker position. All that being said, when we do invest internationally, we do prefer more value-oriented segments, such as European banks and Japan.

However, we still prefer to gain most of our value exposure from our US equity selection. As Dan mentioned, we are overweight US energy. Going back to Kaetlin's comments, in our longer horizon portfolios, we have dedicated positions to small- and mid-cap companies as well.

Thanks for taking the time to chat, Dan and Kaetlin! This was a helpful discussion!

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*Index Definitions:*

*In a rising interest rate environment, the value of fixed-income securities generally declines.*

*Dividends are not guaranteed and are subject to change or elimination.*

*Definitions:*

*Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.*

*Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.*

*'Stagflation' is characterized by slow economic growth and relatively high unemployment — or economic stagnation — which is at the same time accompanied by rising prices (i.e. inflation).*

*US Equities include stocks listed in the United States. Stocks represent partial ownership of a corporation. If the corporation does well, its value can increase, and investors can share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Small/mid-cap equities, MLPs, REITS and alternatives equities are types of US Equities and assume further risks described below.*

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*When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios.*