Narrowing Growth & Increasing Pessimism Lay Potential Groundwork for a Value Comeback in Global Equity Markets

“We believe, the time to invest in value stocks has seldom been better,” ClearBridge Investments Global Value Equity Head Declares

(Wilmington, DE, March 15, 2016) – Concerns over growth, commodity prices and divergent economic policies that limited global equities in 2015 morphed into outright fears to open the New Year, ClearBridge Investments Head of Global Value Equity Paul Ehrlichman recently observed. This ignited a selloff that has led most global equity benchmarks into bear market territory.

“We appear to be heading into a period of maximum pessimism,” Mr. Ehrlichman wrote. “Our timing indicators still point to continued downside in cyclical, commodity and banking sectors.”

“While we don’t know when the selloff will end, we do know that value stocks historically have bottomed in such dire environments. Though painful, a period characterized by recession fears and low expectations is part of a healing process necessary for value to regain its leadership.”

Still, to Mr. Ehrlichman and the ClearBridge Investments team, the key question is how likely it is that value stocks will outperform growth-oriented equities and the overall market.

“We believe the time to invest in value stocks has seldom been better,” he concluded. To support this claim Mr. Ehrlichman observed, “Adding to the odds are extended prior under-performance; depressed earnings and low expectations for cycicals and banks; above-average premiums being paid for quality, growth and momentum factors; below-normal valuations in emerging markets; and negative economic sentiment. Decreasing the case for a reversal in the growth-driven market environment is the currently high level of margins, especially in the U.S.; a low but positive level of global GDP growth; and extremely low interest rates.”

The full text of the ClearBridge Investments The Year in Review 2015 can be accessed via the ClearBridge web site.
In detailing his outlook for 2016, Mr. Ehrlichman noted the unpredictable nature of the markets.

“It is tempting, especially for a disciplined contrarian value manager, to characterize the performance of markets last year as anything but driven by rational fundamentals,” he wrote. “While there are unsustainable trends poised to reverse over the next three to five years, relative share price performance was highly correlated with relative earnings growth in 2015.”

“Therefore, the key to stronger performance from value stocks – and the currently depressed cyclical, emerging market, banking and non-U.S. shares – must be an improving global economy and broadening corporate profit growth.”

Mr. Ehrlichman believes equity losses have been amplified by currency volatility. Thus carry trades, where investors borrow cheaply in weak and falling currencies to invest in assets with higher growth and at higher interest rates, are unwound and loans must be repaid.

“Prior to the recent selloff, the combination of a less robust than expected global economic expansion, and deteriorating corporate earnings growth – along with persistent worries about all things Chinese – led to a challenging 2015 investment environment. Cyclically dependent and higher risk assets substantially underperformed higher quality and defensive assets.”

While U.S. markets performed relatively well – given the strength of large cap technology, consumer and health care stocks and a rising dollar – others were not as fortunate:

- Share prices fell 2.4 percent globally, measured by the MSCI All Country World Index.
- Developed international equities declined an average of 0.8 percent, ranging from an 8 percent gain in Japan to an 11 percent loss in UK stocks.
- Asian shares experienced a drop of 12 percent, weighed down by slowing growth in China and led by significant weakness in Thailand, Malaysia, Indonesia and Singapore.
- Australia, hurt by weakening commodity prices, posted losses of nearly 14 percent.
- Chinese shares in the MSCI index declined 10 percent, while Hong Kong saw a 3.3 drop.
- Despite evidence of continued economic recovery, European markets lost 5 percent overall, with gains in local currencies erased by weakness in the euro.
- Hardest hit was Norway, off by more than 17 percent due to falling oil prices, followed by losses in Spain and Sweden.
- Relatively defensive Denmark led with a 22 percent rise along with solid gains in Ireland, Belgium and Austria.
- Emerging markets experienced the largest outflows in history in 2015 and are now back to the valuation lows of 2009, pulled lower for another year by macroeconomic concerns, falling commodity prices and a rising U.S. dollar. Share prices fell 17 percent, with Emerging Asia off by 12 percent and Latin America hit by nearly 33 percent.
Losses were led by a drop of 43 percent in Brazilian equities and a 62 percent plunge in Greece. Both economies faced political uncertainty and a deepening recession. Poland, Turkey, Peru, Colombia and South Africa declined by more than 25 percent.

On the positive side, Mr. Ehlichman noted:
- Russia ended the year basically unchanged.
- Argentina rallied to close off only 1 percent.
- Hungarian stocks jumped 33 percent on a recovery in local banking and health care.

Meanwhile, nearly $13 trillion sat idle on central bank balance sheets.

“Very little of this capital found its way into the real economy, but instead sought refuge in those rare investments offering both perceived safety and strong growth,” Mr. Ehrlichman wrote. “This created many divergences in relative valuation and performance at levels last seen at the height of the 2000 technology bubble. One of the most popular was the gap in gains between four U.S. technology stocks, dubbed with the acronym ‘FANG,’ and the rest of the S&P 500. Without Facebook, Amazon, Netflix and Google, the index would have fallen by more than 5 percent.”

About Paul Ehrlichman
A Managing Director and Portfolio Manager with 32 year of investment industry experience, Paul Ehrlichman heads the ClearBridge Investments Global Value Equity investment team and co-manages numerous global and international strategies. Prior to launching predecessor firm Global Currents Investment Management in 2008, Mr. Ehrlichman spent 18 years at Brandywine Global Investment Management as Global Equity CIO and Managing Director. Before joining Brandywine Global, he was a portfolio manager with Provident Capital Management and a securities analyst at First Pennsylvania Bank. He is involved with a number of community organizations including Fairville Friends School, The Brandywine Conservancy, Salesianum High School, St. Patrick's Parish of Kennett Square and The Delaware Nature Society. Mr. Ehrlichman earned a B.S. in finance and quantitative analysis from La Salle University.

About ClearBridge Investments
ClearBridge Investments is a well-established global investment manager with $107.5 billion in assets under management as of December 31, 2015. With a legacy dating back over 50 years, the firm’s long-tenured portfolio managers and fundamental research team focus on building equity portfolios for clients who seek income, high active share or low volatility solutions. Owned by Legg Mason, ClearBridge Investments operates with investment independence from headquarters in New York and offices in Baltimore, San Francisco and Wilmington.

About Legg Mason
Legg Mason is a global asset management firm with $651.5 billion in assets under management as of January 31, 2016. The Company provides active asset management in many major investment centers throughout the world. Legg Mason is headquartered in Baltimore, Maryland, and its common stock is listed on the New York Stock Exchange (symbol: LM).

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Morgan Stanley Capital International (MSCI) World Index is an unmanaged index of equity securities from developed countries. Please note an investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

S&P 500 Index is an unmanaged index of common stock performance. Please note an investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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An investor cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.

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