

Investing Arithmetic:

Find the Price Skew That's in Your Favor

For a minimum 8%¹ IRR² over the next decade, which group would you choose?

Growth Stocks		
	Price/Sales	Price/Earnings
Tesla	18	140
Microsoft	12	34
Paypal	10	40

Value Stocks		
	Price/Sales	Price/Earnings
Volkswagen	0.4	6
GE	1.5	26
Halliburton	1.4	15

¹Roughly the average annual return of stocks over the past 50 years. ²Internal rate of return. Source: Factset, Pzena estimates. For illustrative purposes only; data as of September 2021 but may have changed since the time of the recording.

Each is a great franchise. Understanding valuation is key.

Consider the basic investing arithmetic for Tesla and VW. In our view, these are a few of the macro and company forecasts required for each to yield an 8% return.

? Tesla*

- Eye-popping earnings and margins never achieved by a car company
- Average selling price doesn't decline and is 2x the average global car price
- 50% of all cars sold are electric and, Tesla has a 25% market share

Even with these very optimistic assumptions, the best case is likely as 8% IRR; anything worse, you earn less.

✓ Volkswagen*

- Earnings for VW's internal combustion engine (ICE) autos go to zero
- Price points for VW's EVs decline precipitously (30 percent)
- EV share drops, leading to margins 50% below margins currently earned on ICE

Using these extremely pessimistic assumptions, the worst case still likely earns an 8% IRR; anything better, you earn even more.

*Partial list of assumptions. Hear our complete case for all six stocks, as Rich Pzena explains the basic investing arithmetic behind what we feel is necessary to justify the stocks' prices.



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FURTHER INFORMATION

As of September 30, 2021, PIM owned shares of Volkswagen, General Electric, and Halliburton in several strategies and was short shares of Tesla in the Pzena Long/Short Value strategy; Microsoft and PayPal were not held in any of its strategies. The Pzena Long/Short Value strategy is not available at Morgan Stanley Wealth Management.

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