Q4 2023 - Large Cap Value Quarterly Update

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I'm Rich Pzena, Co-Chief Investment Officer of Pzena Investment Management, here today to talk to you about our fourth-quarter performance and the outlook for our domestic value strategies.
The fourth quarter was a, was a strong quarter for us, um, and for value, and we outperformed the value indices substantially during the quarter. The quarter was really characterized by a realization that the, the market came to—that the recession case was kind of off the table—and we started to believe in the soft landing. Interest rates contracted, um, and that played in very well to our portfolio, which is a highly cyclical portfolio with a fairly heavy, uh, exposure to financial services.
In fact, it was the banks that drove our performance, with our four large bank holdings—Citibank, Bank of America, um, Wells Fargo, and Capital One Financial—up between 20 and 30% during the quarter.

On the negative side, um, the biggest detractor from our performance this quarter was Charter Communications, which is a, a cable TV and broadband internet service provider. We bought this stock originally on the basis of, of the strength of the broadband franchise. As we all know, the cable side of the business is in decline, and in fact, at this point, cable is not contributing any earnings to, to Charter. So the whole case, uh, on Charter is, is continued strength in broadband. That was called into question a bit during the quarter with some aggressive, um, marketing of a fixed wireless service by the cellular carriers, who are using excess capacity to provide home-based broadband services in competition with the traditional cable operators.

We've believed that their, their ability to do this is limited, and so, uh, we, we don't believe that this is a long-term threat, but it became a focus of attention in the market, and Charter was a poor performer as a result.

Um, the outlook though remains fairly rosy. Um, we've believed in the quote-unquote soft landing all along, primarily because we didn't really see any signs of excess in the economy that had to be worked off, off, and, and so the market now, I would say, shares our view of, of a sluggish economy but not a negative one. Um, and interest rates having peaked.

But there's still uncertainty. There's still the, the big topic of conversation, and the big question is, do we still have risk of a recession? Are interest rates going to pop back up? Um, and these things still are, are on the minds of investors.

Our portfolio continues to have a cyclical orientation, and even though there were some dramatic moves, as I discussed, in the financials during the quarter, they still remain quite cheap. I'll just use Citi as a specific example of that because the Citi franchise is a bit different than the other banking franchises. Citibank primarily has a corporate client customer base for deposits, and that is different than a retail customer base 'cause you, you can't pay no interest on corporate accounts because corporate treasurers will never accept that.

Having said that, Citi has had lots and lots of problems that were, are regulatory, and they did finally announce that they thought their expense structure was peaking. The expense structure is caused by all the remediation they have to do for, um, regulatory purposes. We think that the substantial expenses will start to come off over the next few years, and Citibank's valuation just made no sense relative to the franchise size. It continues to sell for a giant discount to book value, uh, uh, seven or eight times current earnings and is, is, is massively undervalued compared to other financials and compared to the value of the franchise.