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The Valuation Gap: What History Says the Patient Investor Should Do Now

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Value investing and growth investing represent two distinct approaches to building wealth over the long term, and understanding the difference matters more right now than it has for some time. Value investing focuses on companies that look cheap relative to their underlying fundamentals: low price-to-earnings or price-to-book ratios, solid cash flows and dividends, and shares that have, for one reason or another, fallen out of favour with the market. Growth investing takes the opposite view, backing businesses expected to expand their earnings at pace. The investor accepts paying a full price today in anticipation of what the company might become tomorrow. Put simply, value is about buying something for less than it appears to be worth right now, whilst growth is about backing what it could be worth in the future.

The late 1990s offer a useful historical lens. During the dot-com boom, technology and telecoms shares surged as investors chased the internet story and became increasingly comfortable setting aside traditional valuation yardsticks. When the bubble burst between 2000 and 2002, many of those high-flying names fell sharply. The rotation that followed was substantial. Investors moved back towards companies with steadier earnings, stronger balance sheets and more reasonable valuations. Broad value indices outperformed meaningfully over the years that followed as capital flowed back into financials, industrials and consumer staples. There are echoes of that period in today's markets. A relatively narrow group of large, growth-oriented companies, concentrated in US technology and AI-related names, has driven much of the market's gains in recent years. The consequence is that a great many value-oriented sectors now trade on materially lower valuations.

That valuation gap is not confined to the UK. Across much of Asia and the wider emerging markets, forward price-to-earnings ratios sit meaningfully below the global average, and the gap with the US is especially pronounced. Dividend yields in these regions tend to be higher too. The UK equity market itself remains cheaper than its US counterpart, and when combined with selectively chosen emerging market exposure, there is a genuine opportunity to broaden diversification and tilt portfolios towards areas where valuations provide a more solid foundation.

It is against this backdrop that we at Tacit, have positioned our portfolios. Rather than concentrating exposure in a narrow band of expensive growth leaders, we have deliberately tilted towards assets that offer better valuation support and a wider opportunity set. UK equities form an important part of that. The market's attractive valuation and relatively generous dividend yield, combined with its natural weighting towards cash-generative and more traditionally valued businesses, provides a meaningful anchor of value-oriented holdings, one that stands to benefit further if the recent broadening of market leadership continues.

Alongside this, we hold emerging market equity funds where managers are focused on quality balance sheets and sustainable cash flows but can still access those characteristics at a discount to developed markets. The combination of lower starting valuations and stronger long-term structural growth drivers makes this a natural complement to our developed market positions.

We balance these with more modest, carefully selected growth allocations, in areas such as technology and AI, to ensure our clients still participate if recent growth leadership persists, without overpaying for that potential. Taken together, our portfolios are diversified across styles, regions and underlying managers, but carry a clear tilt towards assets where valuations look more supportive in the current higher-for-longer interest rate environment.

That is precisely the kind of positioning that served investors well in the years following the dot?com unwind, when attention shifted back to what was actually being paid for underlying earnings and cash flows.

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