

HQ Asset Management

Stock selection

HQAM factor of the month: Comparing apples and oranges

October 2021

In theory, value investing is quite simple: This investment style is all about buying assets at a discount to their intrinsic value. Famed value investor Warren Buffett once summed it up this way: "Buy a dollar, but don't pay more than 50 cents for it."

That it's not quite that simple in practice can be seen by looking at the value metric "tangible common equity to market cap," which is all about so-called tangible equity: that's the amount of money investors would receive if a company liquidated all of its assets.

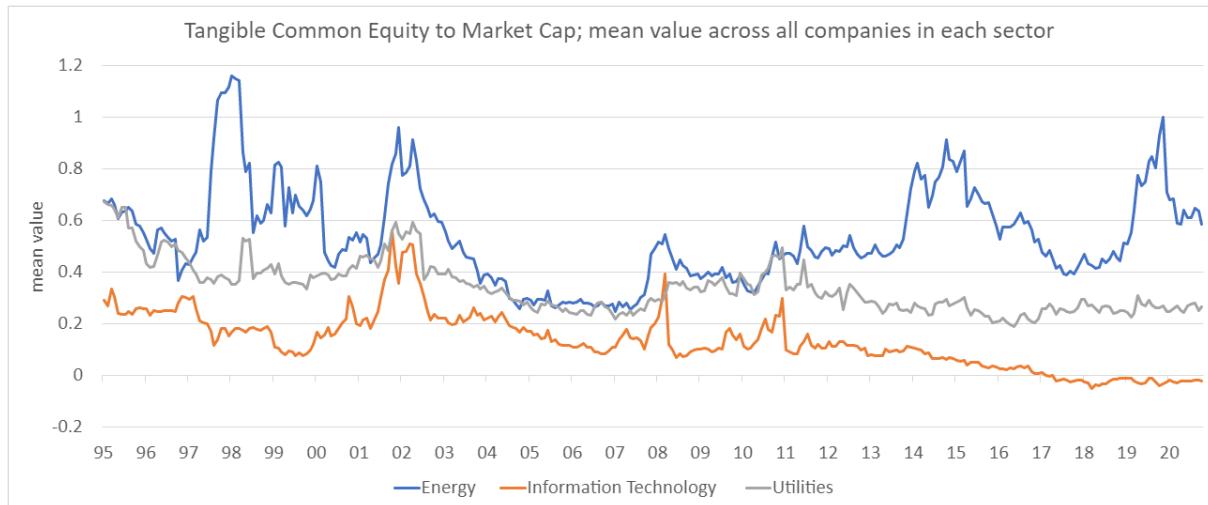
The ratio is calculated by first subtracting intangible assets such as patents or brand value from equity. This figure is then set in relation to the current stock market value. The higher the ratio of tangible equity to market capitalization, the more attractive the share.

The problem

- When it comes to the composition of a balance sheet made up of tangible and intangible assets, there are very big differences between the sectors.
- While energy companies often have a lot of money invested in tangible assets, IT companies often have high intangible assets.
- If value investors did not adjust their stock selection data for these sector effects, they would only be invested in energy companies.

The solution

- In stock selection, it is important to compare companies with one's own peer group. Otherwise, you are comparing apples with oranges and have large sectoral deviations in your portfolio.
- In the field of artificial intelligence (AI), this problem is called "bias."
- With AI, it is possible to clean up these sector effects: Each stock is only compared with its own peer group. This means that companies from the information technology sector can be bought and energy companies sold.



Sources: HQAM, S&P Capital IQ. The analysis refers to the European equity universe (MSCI Europe); Tangible Common Equity to Market Cap is calculated monthly using the following formula: (Total Common Equity - Goodwill - Other Intangibles) / Market Capitalization; The period of calculation is from Dec. 31, 1994, to Sept. 30, 2021. The companies in the sectors are equally weighted.

To the background:

It's no secret that favorites change on the stock exchange - sometimes stocks with a low P / E ratio are in demand, sometimes with high dividends, sometimes small and sometimes large caps. HQ Asset Management (HQAM) deals very intensively with such factors. As part of the research process, HQAM uses artificial intelligence to analyze around 200 factors every month and determine which have been able to best explain the price development of the individual stocks recently - and should continue to do so.

The research team analyzes one of these factors under the heading "HQAM factor of the month". The experts at HQ Asset Management explain the background and context and point out special features that can support investors in putting their portfolio together.

To HQAM:

HQAM is one of the financial service providers of the Harald Quandt family. The company offers a clear focus on quantitative asset management for institutional and semi-institutional investors. As the next generation asset manager, HQAM relies on the use of modern technology, alternative data and methods of artificial intelligence when making investment decisions.

Please note:

Investing assets in the capital markets is associated with risks and in extreme cases can lead to the loss of all of the capital invested. Past performance is not an indicator of future performance. Forecasts are also not reliable in terms of future performance. The representation is not investment, legal and / or tax advice. All content on our website is for informational purposes only.



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