

# *An Analysis of Value Investing in Different Industries*

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**Abstract:** This paper navigates through diverse sectors, starting with real estate, where value investing demands a nuanced understanding of unique challenges, such as low liquidity and strategic leverage use. The technology sector, with its disruptive innovations, challenges traditional investment paradigms. Examples like Amazon reshaping retail underscore how disruptive technologies erode value in traditional sectors. In healthcare, the impact of clinical trial results on stock performance is dissected using Moderna and Pfizer as case studies, highlighting the sector's asymmetrical response to positive and negative outcomes. This paper concludes by addressing the limitations of value investing, emphasizing challenges related to time horizon, industry dynamism, and market efficiency assumptions. This paper advocates for a balanced approach combining historical wisdom with adaptability in a dynamic market landscape. Acknowledging the limitations, investors are encouraged to embrace a forward-looking mindset, recognizing the evolving nature of industries. The resilience of value investing lies in its storied past and its ability to adapt, offering a guiding philosophy for modern investors navigating multifaceted financial terrains.

**Keywords:** Value Investing, Real Estate, Technology, Healthcare

## 1. Introduction

Value investing is deeply rooted in the wisdom of financial stalwarts such as Benjamin Graham and Warren Buffett and has long been a beacon in turbulent investment strategies. This investment philosophy is based on a detailed analysis of intrinsic value and a focus on long-term returns, enduring the storm of economic fluctuations and leaving an indelible mark on the financial community. When exploring value investing, it is crucial to delve into its historical evolution and create groundbreaking cases that shape its enduring heritage. Value investing, as an investment philosophy, can be traced back to the pioneering work of Benjamin Graham, often regarded as the father of value investing and his outstanding disciple Warren Buffett. Graham's groundbreaking work, "The Intelligent Investor", laid the foundation for evaluating stocks based on their intrinsic value, emphasizing the safety margin of investors. Buffett has become synonymous with the success of value investing by keenly applying Graham's principles, turning Berkshire Hathaway into a value-driven investment giant.

Many in history demonstrate the success of value investment. Warren Buffett demonstrated the inherent resilience and profitability of value-oriented choices in his strategic investment in American Express during the crisis. In addition, the founder of Inditex (Zara's parent company), Amancio Ortega, has extended his entrepreneurial ability from fashion to global real estate investment, achieving significant growth and value accumulation. In the technology field, SoftBank's investment

in Alibaba reflects the intersection of technology and value investment, achieving considerable returns and highlighting the potential of the vibrant technology industry to create value. These historical cases emphasize the effectiveness of value investment in different industries, emphasizing its different investment methods and timing under various market conditions.

As it transitions from the historical perspective of value investment, addressing its enduring relevance in the contemporary investment landscape is necessary. In an era where industry trends constantly evolve and traditional industries gradually diversify, value investment has elasticity. As emphasized in Morgan Stanley's 2022 Value Investment Outlook, the post-pandemic investment situation emphasizes that healthcare, energy, and commodities will become viable industries for value-driven investment [1]. The enduring relevance of value investment lies in its ability to adapt to new industry trends. After the epidemic, industries such as healthcare and technology have become the focus of value investors due to their inherent stability and growth potential. Similarly, the classic investment field of real estate is undergoing transformation, providing savvy value investors with unique opportunities to identify undervalued assets. As crossing various fields, different enduring principles of value investment will become the guiding compass, illuminating the path of wise and cautious investment decisions.

## 2. Value investing in real estate sector

Value investing in the real estate sector involves a nuanced understanding of the industry's unique characteristics and challenges. Real estate investments are distinctive due to the multitude of factors associated with the properties themselves, including durability, indivisibility, scarcity, location, and Capital-intensive nature [2]. The locality and heterogeneity of the real estate market further exacerbate the complexity of value investment in the industry. The highly localized nature of real estate characteristics requires a keen understanding of the specific dynamics that affect each market. In addition, the inherent low liquidity of the real estate market poses challenges for investors seeking quick returns or portfolio liquidity [2]. These market attributes shape the navigation pattern of value investors, requiring a strategic and patient approach to identify opportunities in the unique challenges of the industry.

A significant feature of real estate investment is the widespread use of high leverage; a real estate investment often consists of a permanent loan of 70 to 80 percent of the purchase price [3]. The leverage role in real estate investment involves investors' strategic decisions to maximize returns while managing related risks. The timing and degree of leverage used in real estate investment are crucial in optimizing the overall leverage ratio to improve shareholder returns. For example, investors can adjust their leverage ratio based on expected changes in demand by increasing the overall leverage ratio during the expected period of demand growth to maximize equity returns or by obtaining asset-backed non-recourse loans when there is a significant decrease in expected demand. The strategic use of leverage has become a key factor in real estate investment success [4].

Nowadays, instead of leverage, more investors are preferring mezzanine financing. Mezzanine financing is considered a hybrid instrument as it combines elements of debt and equity. It often involves a higher level of risk, which is reflected in the higher interest rates, but it allows the investor to participate in the potential upside of the investment even when the interest rates on such loans exceed the target after-tax rate of return to equity. Mezzanine financing allows real estate investors to achieve higher levels of leverage. Mezzanine loans enable investors to access additional capital beyond traditional lending limits by filling the gap between senior debt and equity. This higher leverage potential can amplify returns on equity. Moreover, Mezzanine financing provides flexibility in structuring the capital stack. Investors can tailor the financing mix to suit their specific needs, combining mezzanine loans with senior debt and equity. This flexibility allows for a customized approach to optimizing the capital structure of a real estate investment.

As delve deeper into the real estate sector, it will explore company cases that highlight the dichotomy between market prices and intrinsic values. Over the past five decades, researchers have extensively explored the precision of subjective dwelling valuations, primarily relying on data from the United States. Despite variations in estimates, ranging from a negative 2% to a positive 16%, a consensus among scholars suggests that, on average, homeowners exhibit a tendency to overvalue their properties by approximately 5%. Moreover, people living in the bottom eight-tenths of the price distribution are skewed upward, while those living in the most expensive housing generally underestimate the value of their homes [5].

### 3. Value investing in technology

The technology sector, characterized by its consistent growth and dominant presence, has become the largest sector in the S&P 500, reaching new heights in 2018. However, traditional capital budgeting, investment experience, and intuition may only sometimes be effective in guiding investment decisions in the realm of information technology (IT). Common uncertainties in technology investments stem from factors influencing a company's ability to realize business value, including internal technical capabilities to overcome challenges in IT projects and external issues causing uncertainty in input costs, such as fluctuating input costs and government regulations impacting costs and returns in different ways.

Interruptive technology was coined by Harvard Business School in 1995 to describe how a new company with relatively few resources successfully challenges a large, established company [6]. Disruptive technologies significantly influence consumer processes, reshaping various aspects from transportation to the retailing of electronic product connectivity and even contributing to societal transformations. For instance, ride-sharing applications have completely changed how people commute, jeopardizing traditional taxi businesses. Convenience and a greater selection of options have been brought about by the transition in the e-retail industry from physical storefronts to e-commerce platforms. The Internet of Things (IoT) and other linked technologies have changed how devices communicate, resulting in connected lifestyles and smart homes. Disruptive technologies bring about social transformation, like social media platforms, which have transformed the dissemination of knowledge and communication.

These disruptions have profound implications for investments in the technology sector. Investors need to be attentive to companies embracing and driving disruptive innovations, as they are likely to be at the forefront of industry evolution. Identifying companies that leverage disruptive technologies to enhance consumer experiences or streamline processes can present attractive investment opportunities. Additionally, understanding the broader societal impact of these innovations can help investors anticipate trends and position their portfolios for long-term growth in the dynamic technology sector.

One of the most prominent examples is the impact of Amazon on the retail sector. Traditional brick-and-mortar retail companies, accustomed to a traditional business model, face unprecedented challenges due to Amazon's disruptive technology. The e-commerce giant has transformed consumer behavior, emphasizing the convenience of online shopping. As a result, investors in traditional retail companies are witnessing significant volatility and declining valuations. For instance, Amazon's ability to optimize supply chains, provide personalized recommendations through machine learning, and offer seamless online experiences has disrupted the traditional retail landscape. This case underscores how disruptive technology can quickly erode the value of investments in traditional technology sectors [7].

At the same time, the position of traditional energy companies in the market capitalization index has been greatly affected. Existing traditional energy companies face a trend of exiting the market capitalization index due to the rise of clean technologies and increased global demand for sustainable

energy. This includes some traditional oil and gas companies, whose market capitalization and weighting are declining as investor interest in new clean energy sources grows. Investors are investing more in clean technologies, surpassing traditional energy sources for the first time. Data from the S&P Global Clean Energy Index shows that as of October 31, 2019, the one-year total return for clean energy was 35.39%, while the one-year total return for the Global Energy Index was only 7.74% [8]. This again emphasizes investor preference for clean and renewable energy and the market's pursuit of sustainability.

#### 4. Value investing in healthcare

The healthcare sector, characterized by its critical role in improving and sustaining human health, presents unique challenges and opportunities for value investors. This sector spans a wide range of industries, including pharmaceuticals, biotechnology, medical devices, and healthcare services. Against the backdrop of the COVID-19 pandemic, the healthcare industry has garnered significant attention from global investors. The sector plays a pivotal role in preventing the spread of the COVID-19 outbreak, mitigating health disasters, safeguarding and enhancing public health, improving the quality of life, and fostering economic development and societal progress.

For biopharmaceutical companies, the outcome of clinical trials is of paramount importance. Clinical trial results not only determine the efficacy and safety of a potential treatment but also have a profound impact on determining the future revenue, growth, and valuation of the company. A notable example is Moderna's announcement of positive mid-phase trial data for its mRNA vaccine targeting SARS-CoV-2. This revelation led to a staggering 35% increase in Moderna's stock within a single day. Similarly, when Pfizer declared mid-term results for its third-phase vaccine targeting the severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2), the stock witnessed a 9.2% surge on the day of the announcement [9].

The healthcare market's response to positive and negative outcomes is often asymmetric. Studies indicate that negative events, such as disappointing clinical trial results, tend to elicit a more significant negative market response compared to the positive reaction generated by successful outcomes. It will also lead to more substantial declines in stock performance. This asymmetry, in response, is a critical factor for value investors to consider. Understanding this market behavior is crucial for making informed investment decisions in the healthcare sector.

The profitability of healthcare sector companies is often closely related to the demand for their products; fluctuations in product demand directly affect a company's sales and profitability. For example, the demand for drugs is closely related to the spread rate of diseases. In the event of a pandemic or sudden public health crisis, drug demand may sharply increase, driving up company profits. However, this change in demand also poses challenges as companies need to be flexible in responding to market demand fluctuations to ensure timely patient and market needs satisfaction. Global outbreaks, such as COVID-19, have rapidly increased vaccine demand. However, this also means that vaccine demand may decrease once the epidemic is under control, posing a potential threat to the company's profitability. In the November 2023 update, Pfizer reported a 41% operational decline in sales and losses due to past the COVID-19 era [10].

In addition to clinical trial outcomes and demand, regulatory dynamics significantly shape the landscape for value investors in the healthcare sector. The sector operates within a stringent regulatory framework, where drug approvals, compliance with safety standards, and adherence to evolving healthcare policies are pivotal determinants of success. For value investors, understanding the intricate regulatory environment is crucial for assessing investment risks and opportunities. Regulatory approvals, especially from agencies like the U.S. Food and Drug Administration (FDA) and the European Medicines Agency (EMA), can transform healthcare companies. Positive regulatory milestones, such as drug approvals or expanded indications, often lead to substantial stock

price increases. Conversely, regulatory setbacks, such as approvals or safety concerns delays, can result in significant market downturns. Thus, the regulatory pathway is a critical aspect that values investors need to monitor closely. A notable example is the pharmaceutical industry, where the drug development process is marked by rigorous regulatory scrutiny. A company's ability to navigate the complex regulatory landscape, obtain approvals, and meet compliance standards greatly influences its growth prospects. Biopharmaceutical firms that successfully bring innovative therapies to market, addressing unmet medical needs, are often rewarded with market outperformance.

## 5. Conclusion

In conclusion, value investing, rooted in the principles of financial visionaries like Benjamin Graham and Warren Buffett, has endured as a guiding philosophy amid economic uncertainties. Its historical evolution, marked by the foundational work of Graham and exemplified by Buffett's success, showcases the resilience and effectiveness of this investment approach. From strategic investments during crises to the adaptability to evolving industry trends, value investing has proven its mettle.

As it navigates through different sectors, the nuances of value investing become evident. In real estate, the unique challenges, such as high leverage and the need for patient strategies, shape the value investor's path. Mezzanine financing emerges as a flexible alternative, providing higher leverage potential and customization in structuring capital stacks. The technology sector, with its disruptive innovations, challenges traditional investment approaches. The transformative impact of companies like Amazon on retail exemplifies how disruptive technologies can swiftly erode the value of traditional investments. Meanwhile, the energy sector is undergoing a significant shift as clean technologies outpace traditional sources, emphasizing investors' preference for sustainability. Amidst the COVID-19 pandemic, the healthcare sector has gained prominence, with clinical trial outcomes playing a pivotal role in stock performance. Understanding the asymmetry in market responses to positive and negative events is crucial for value investors in this sector.

While value investing stands as a resilient and effective investment philosophy, it is not without its limitations. Understanding these limitations is crucial for investors aiming to navigate the complexities of the modern financial landscape. The foremost limitation of value investing lies in its time horizon. The traditional value investing approach advocates a patient, long-term strategy, waiting for the market to recognize the intrinsic value of a stock. However, in today's fast-paced markets, where information travels swiftly, the effectiveness of this approach may need to be improved. Investors often face the challenge of balancing the long-term commitment of value investing with the desire for more immediate returns. Moreover, the need for time to witness the effects of value investing can deter some investors. In an era driven by rapid technological advancements and dynamic market shifts, the delayed realization of returns may need to align with the expectations of those seeking quicker, more agile investment outcomes. The evolving nature of industries, especially in sectors like technology and healthcare, demands a level of adaptability that traditional value investing might find challenging.

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