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3 Bargain Stock Picks by a Top Value Manager

By Reshma Kapadia

What investor doesn't like mispriced stocks? That is why Sarah Ketterer, chief executive of Causeway Investment Management, is increasingly digging into China's domestic, or A-shares market, where a young analyst community and limited foreign interest creates fertile hunting ground for value managers.

"China will be the world's second-largest, if not the largest, stock market in 10 years," Ketterer told Barron's at the Investment Company Institute's annual membership meeting last week in Washington, D.C. "There's some rubble but also some tremendous opportunities. I have never seen such price inefficiencies."

While foreign investors are increasingly beginning to pay more attention to domestic Chinese stocks as the MSCI Emerging Markets Index increases its exposure to them, Ketterer says the market is still untapped. On a recent visit to a company, three hours from a major city, she said executives told her she was the first global investor to visit all year.

The 12% return this year for the $6.8 billion Causeway International Value (CIVVX) fund Ketterer co-manages has beaten three-quarters of its peers, and its 8% average annual return over the last decade has outpaced 84% of peers. While value continues to lag growth—and is taking longer to come back than Ketterer and other value managers expected—there are some bargains Ketterer is willing to own patiently, even if she's early.

And it isn't just far into China where Ketterer sees opportunities. Here are three.

Baidu (ticker: BIDU): The Chinese technology company is the least loved of the so-called Chinese BATs, which include Alibaba (BABA) and Tencent Holdings (0700.HongKong). But Ketterer cites Baidu's dominance in search and its ability to generate cash. Baidu also has stakes in businesses such as iQiyi (IQ), which went public in March. The value of the company, described as China's version of Neflix, isn't reflected in Baidu's market cap, Ketterer says.

She also sees a possible catalyst in the future—its autonomous vehicle business. In a separate note out on Friday about the investment opportunity in the "mobility as service" revolution—think ride sharing, Tesla, autonomous vehicles—DataTrek Research co-founder Nicholas Colas said technology companies may be the safest way to invest in the theme. "For them, getting to the finish line on autonomous driving is the gravy, not the whole meal, when it comes to their investment case."

Volkswagen (VOW.Germany): Auto

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stocks have been in a rut, hit by weak demand from China, the world's largest auto market in terms of sales, and the costs of investing in the future in areas like electric. But Ketterer says Volkswagen has the ability to improve productivity and boost its margins further. It is already making progress. In 2015 when Volkswagen was caught in a diesel emissions-cheating scandal, the car maker had 23 billion euros in net cash. Even after paying settlements related to that scandal, net cash now sits at roughly 24 billion euros, Ketterer said. The reason: The company has restructured and improved productivity—and can still do more. That may be resonating with other investors. While Volkswagen reported a 10% decline in its first quarter profit this week, shares rose after the news.

Barclays (BARC.UK): Value managers tend to flock to the epicenter of pain. Ketterer is no different. She thinks European banks are "recklessly priced," factoring in a recession and trading near price-to-tangible-book values similar to where they were in the Eurozone crisis. Yet, they have abundant amounts of capital. Interest rates don't need to rise for the stocks to gain, Ketterer says. Instead, the companies just need to be more efficient.

Among her favored bets is Barclays, which sits in the middle of Brexit concerns and is the target of an activist investor who wants the bank to rethink its ambitions and narrow its focus. "Everyone has given up on it," Ketterer says. But Barclays has cleaned up its balance sheet, has a good credit-card and mortgage-lending business and is investing in technology—and Ketterer thinks the company can return more cash to shareholders on top of 4.9% dividend yield it already pays. "It seems so obvious that it's valuable," Ketterer said, adding that too many people are chasing the future, with companies like Uber and WeWork, and not seeing what is in front of them today.

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