Causeway's Sarah Ketterer: 'I Don't See Any Overvaluation Anymore'

How this stock market decline is different. Uncovering value in European banks, Asian electronics, Carnival.

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Some investors can deliver the most outperformance during market crises. So says Sarah Ketterer, cofounder and CEO of Causeway Capital Management. Shes's also co-manager of many of Causeway's funds, including the Gold-rated Causeway International Value CIVVX and Causeway Global Value CGVVX. Indeed, Ketterer and her team are shopping during the stock market's downturn, looking for cheap companies transforming their businesses while avoiding those that look cheap but are only destined to get cheaper.

"I don't see any overvaluation anymore," she tells Morningstar. In the coming months, she reckons her team will "make more money for our clients on the rebound, in banks and other cyclicals." Ketterer chatted with Morningstar on Monday, April 7, as stocks sank. For more, keep reading the following edited and condensed excerpts of the conversation.

Leslie Norton: You've seen a few bear markets. How is this one different?

Sarah Ketterer: It's ideological. The Trump administration is asking American voters to take pain before gain. I've never seen that. They're taking a tack that has historically proven ruinous. The idea of returning to a US manufacturing glory day where labor is willing to work for low wages equivalent to Southeast Asia is hard to imagine. If we need to automate to be so productive that we can make affordable textiles and consumer electronics, that doesn't bode well for labor either.

I underestimated how ideologically driven our current administration is. We liken this to Brexit in June 2016. We said "The Brits will never do it. That's just crazy." But they did. We didn't put a big enough probability on such extreme tariffs. Now we need to work with what we have.

What does the administration want? It isn't obvious, other than chaos. Is this purely for revenue raising, in which case the very slow onshoring of manufacturing will displace the revenue? Or to put China in its place? My theory is it's a game of chicken with China and Asian allies, in advance of an even more difficult next couple of years with China.

Norton: Please share some of your scenarios.

Ketterer: My guess is voters will put up with it for a brief amount of time. To the degree that everything is getting more expensive other than prices at the pump, voters will be angry. That means bad poll results for the incumbent party. Republicans will be concerned about the 2026 midterms and withdraw the punitive tariffs fully, if not partially. The downside scenario is that the Republican Party is so tightly knit that the storm gets worse and other countries retaliate. A trade war will destroy wealth everywhere.

Holding High-Quality Companies in a Stock Market Downturn

Norton: How are you navigating the downturn?

Ketterer: The same tools apply. We remain diversified. We ensure we hold the highest-quality companies in a downturn. Every downturn is a little different. In 2020, we pushed our client portfolios and our mutual funds into companies in an oligopoly or a duopoly—in aviation, aerospace, hospitality. They were all destroyed and it was an opportunity to own some of the world's best companies.

This downturn is more connected to China and Asia's supply chains. That's where we may end up, putting more emphasis on electronics and some of the semiconductor firms that are Asia-based or use the Asia supply chain. There are quite a few, like Renesas Electronics and

Samsung Electronics SSNLF. Only so many firms have the technological expertise to make industrial semiconductors or memory or whatever. These are oligopolies. The pricing power is minimal, because often there's a glut, and it can get very cyclical. But they have a limited number of competitors. It puts them in a good position for recovery. In 2008, we bought financials to get the tailwind, because they were hit hardest in the global financial crisis. In this case, the closer to the Asia supply chain, the more wicked and difficult the market.

The best we can do for clients in every downturn is upgrade portfolio quality to companies that trade at valuations that aren't suitable long term, that far underestimate long-term earnings and cash flow power.

Avoiding Value Traps

Norton: How do you circumvent the value traps, situations where stocks look cheap but the fundamentals keep deteriorating? Banks and financials were viewed as value traps for a while after the global financial crisis.

Ketterer: We're always looking for value traps, whether markets are buoyant or in the bear stage. The characteristics are often the same: Poor governance and management and a board unwilling to work for shareholders. There's a level of complacency, an often-lazy balance sheet where they don't return capital to shareholders in a regular fashion. They're just cheap stocks that remain that way. A value index is full of low P/E, low price to cash, low price to book, stocks of companies that will stagnate for years.

Unless we make a gross error, we should never find ourselves in value traps. The way we got through 2018 through 2021, the most horrific period any of us have seen for value, wasn't by doubling down and buying cheaper and cheaper stocks. It was by finding companies where the management team had committed to operational restructuring, ensuring greater efficiency, pruning low return businesses, repricing contracts, running the business more efficiently to generate more earnings and cash flow. We believe we can find those managements, especially when they're newly installed in a business at that turning point. It allows us to redefine value. Rolls-Royce RYCEY is archetypal. We bought it in 2019, it collapsed when covid hit, a new CEO transformed the business, and because they only had a couple of competitors, they had pricing power. The stock rose sevenfold from the lows.

When companies have missteps, as long as there is cognizance and willingness by the board and management to turn the business around, there's a great opportunity. You find that a lot, particularly outside the US, where governance just hasn't been as good.

Norton: Going into this market crisis, how were you positioned?

Ketterer: We had the highest allocation to consumer staples in a decade. We owned utilities and built up healthcare. We'd taken profits in a lot of banks. We rank stocks on risk-adjusted return, and our risk model wanted more defensiveness. We can't really hold cash, because investors hate it in the funds and the institutional accounts.

The Case for European Banks

Norton: What are you finding in Europe?

Ketterer: We've been buying more European banks, where we're looking at an upward sloping yield curve for the first time in ages, all good for banks to return capital to shareholders. During covid, European banks were prohibited by their regulator from paying dividends. They built up excess capital, and they've been returning the surplus, but they're still overprovisioned for an economic slowdown. We buy banks as the skies are darkening because they're early cyclicals, and the bottom is there before you see any little glimmer of recovery.

Then, you have this European catalyst, after the Trump administration said Europe needed to spend on defense. We're buying beneficiaries of increased defense and infrastructure spending in Europe.

Norton: What else do you like?

Ketterer: We're looking for special situations. We bought more of cruise operator Carnival CCL because it plunged. They're generating tons of cash. They sold out 80% of bookings for 2025. They'll be able to repay debt with ease.

They have very good management for the first time in a while. It's not recession proof, but definitely one of the last things consumers give up is travel. Even the worst-case scenario doesn't last forever. Markets have a habit of pricing in downturns indefinitely.

We'd love to own more of the Mag 7. They got very pricey from a value perspective. We're looking at companies like Alphabet GOOG or Meta Platforms META, because after we get through a digital advertising downturn, we'll have an upturn.

We've been buying services: Fujitsu FJTSF in Japan, Cognizant Technology Solutions CTSH in the US, Capgemini in Europe CAPMF. Companies are saying they're pulling back on capex, only spending on mission-critical IT services. They have to get data into the cloud and it has to be cleaned and organized and ready in the context of using increasing amounts of artificial intelligence.

Check the Book Value

Norton: How do you value these companies, particularly in a volatile market?

Ketterer: We think of book value. We own world class industrial automation companies in Japan, Fanuc FANUF and SMC SMCAY, which provide automation tools and solutions to automakers globally. They sell to the US. They're getting hit with concerns about tariffs. We don't think they'll lose money. We think they'll find a way to cut costs. If a company trades at book value, the market's saying they'll just earn their cost of capital. If they start trading at discounts to book, the market's saying this company is going to destroy capital forever, and that doesn't happen in world class companies.

Norton: What still looks overvalued?

Ketterer: Nothing. I don't see any overvaluation anymore. But some valuations are more appealing than others. I'd say 12 months from now we're going to make more money for our clients on the rebound, in banks and other cyclicals.

Norton: At what point is the decline overdone?

Ketterer: When the rate of change in earnings forecasts is zero. Stock markets move on liquidity and earnings. We haven't yet seen what the downgrades will be, because we don't know where tariffs were settle. When we're no longer downgrading earnings, when earnings are no longer falling, that's the bottom.

Norton: Thanks, Sarah.