RBC BlueBay
Asset Management

Global Equities: what's a share price worth?

For professional investors only | Marketing communication

Jeremy Richardson
Senior Portfolio Manager,
Global Equities

Published September 2025

"The growing significance of 'technical' trading weakens the connection between share prices and company fundamentals, amplifying mispricing opportunities."

Key takeaways

- Divergent expectations of individual market participants create multiple perceptions of fundamental value. Public market share prices record the outcome of a negotiation between unknown buyers and sellers based upon their own inputs. This makes share prices an imperfect valuation tool but is nevertheless the least worst of those available.
- Increasing market sophistication is eroding the link between expectation-driven share prices based upon company fundamentals and replacing it with technical driven trading. Unanchored by fundamentals, share prices are free to diverge, increasing market mis-pricings.
- This creates volatility, testing the mettle of active investors. But more technical-led mis-pricing also means more opportunity for the active investor, opportunity that the a passive approach won't be able to access.

Of the many meetings I attended as a trainee accountant one in particular made a long-lasting impression. I had spent several weeks on an assignment at a manufacturing business helping to pull together the completion accounts on its sale. At the end of the process the owner sat down with the buyer to go over the final figures and make any necessary adjustments to the amount that had been initially agreed.

As a junior, my role was merely to support the selling owner, proffering the relevant schedule of workings at the right moment. These had all been meticulously prepared to show the final reckoning in a way that was 'true and fair', the Hippocratic oath of all trainee accountants.

Yet the meeting wasn't so much a signing-off of the work that had been done but instead a detailed, line by line, negotiation of each of the variances against the notional firm value that had been initially agreed. Valuations of working capital, pensions and tax claims were all traded against each other as each party haggled for advantage.

It was a revelation to me that the hours of detailed work I had put in to verify each total counted for so little. I had spent years trying to get to the right answer, academically and professionally, but 'right' and 'accurate' clearly weren't what mattered in this meeting. It was a negotiation where a compromise had to be found.

At the end the two parties stood up and shook hands on the outcome. To my eye the buyer seemed happier with the compromise than the seller was. I had gone into the meeting feeling confident in the quality of the work and that the integrity of the completion accounts were beyond question. But the negotiation had demonstrated something important: that valuation wasn't an exact science. That a valuation couldn't be irrefutably *proven* as such. At best it might be justified.

Investing textbooks teach us the ways to value a company and that in theory a share price may be calculated as the discounted sum of future cash flows. If one follows the process correctly, therefore, one should arrive at the 'correct' valuation.

Yet in practice share prices are moving all the time. Buyers and sellers may read the same textbooks and use the same valuation theory but clearly there must be other differences that leads to the daily dance of share price movements.

One such source of difference is that investors are not using the same mathematical inputs. Their expectations of the future are different. Those differences may arise from divergent views over the strength of the future cashflows, different preferences for the timing of expected cashflows, or maybe a different attitude to risk.

It is these divergent expectations and motivations for trading that create a market. The share prices that are shown on the daily exchanges are not any more a 'correct' valuation than the completion accounts I had helped prepare. Rather they are the outcome of a negotiation between buyers and sellers. Each party may have had their own motivations and expectations but found sufficient compromise at that moment to affect an exchange.

"Our approach to valuation rests upon our own set of company-specific expectations, formed after applying our Competitive Dynamics framework."

One might wonder, therefore, why we use share prices to value portfolios at all? After all, we know very little of the expectations and motivations of the two unknown actors who found agreement at the particular moment that provided the market's reported price. One might thus argue that remaining invested and not selling at the market-reported price is an implicit signal that in our view the price is too low. It doesn't reflect our expectations of the future. We might consequently feel that to price an investment using somebody else's expectations and motivations makes little sense.

Private market valuations typically avoid such shortcomings by basing portfolio valuations of unquoted investments upon future fundamental cash flows, discounted back to a current valuation. Critics argue that this is 'marking to model', not 'marking to market', but at least such an approach to valuation may be justified by a set of underlying assumptions that owners may query with the valuer. The model does not rely upon a negotiated compromise between unknown parties to value the portfolio and consequently avoids much of the volatility one finds in public markets that comes from the shifting motivations of unknown market participants and their changing expectations.

In contrast, public market portfolio valuations are based upon transparent market prices. They are tested in a way that private valuations are not as they are validated by the independent actions of other market participants. They also benefit from the presence of many such actors. That creates competition amongst buyers and sellers, helping to close the gap between them and creating sharper prices.

A bit like Churchill's remark that *"It has been said that democracy is the worst form of Government except all those other forms that have been tried"*, public market valuations are not perfect but are the most robust method we have. As in the completion accounts negotiation, public market valuations are at least 'justified', even if we cannot consider them 'proven', being as they are the result of a subjective agreement of unknown independent participants.

Our approach to valuation rests upon our own set of company-specific expectations, formed after applying our Competitive Dynamics framework. This also takes into consideration the important extra-financial drivers of long-term fundamental corporate performance – what we call 'contingent assets'. It is our belief that this should lead to a more relevant set of cash flow expectations and hence a more relevant valuation.

This involves detailed, bottom-up fundamental analysis. Yet so many of the market transactions we observe are not determined by company cash flow expectations at all. For example:

- Buys and sells to reflect flows of open ended mutual or exchange traded funds.
- Passive investment strategies seeking to mimic index changes.
- Risk management transactions, such as option traders seeking to hedge exposure to an underlying entity.
- Fast Trading by algorithmic strategies, such as Momentum following models.

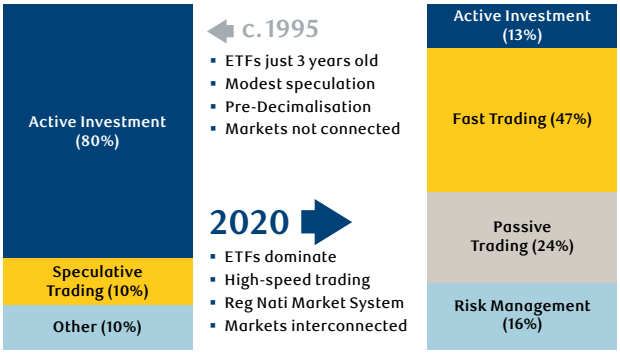
There may be legitimate reasons for each of these trading examples but none of them rely upon a detailed assessment of the cash flows of the underlying corporate. This might not matter for an isolated instance; there are many millions of transactions in public markets and the quality of the pricing signal is unlikely to be compromised if only a modest proportion of those transactions are 'technical' rather than fundamentals based.

But the nature of the market has changed over time and such 'technical' transactions account for a growing proportion. Computers and digital technology have allowed markets to become more sophisticated. Company shares are no longer traded based upon their own prospects but may be combined or sliced and diced in numerous ways to create a return profile that matches investors' needs. Indeed, in the U.S. today there are more indexes and ETFs than there are listed companies with the return of any company further distilled into capital, dividend and option value. Each of these may be quickly arbitraged to exploit any pricing opportunity.

"Company shares are no longer traded based upon their own prospects but may be combined or sliced and diced in numerous ways to create a return profile that matches investors' needs."

The result is that over the last twenty years, a declining proportion of market trades is coming from investors weighing their own expectations and motivations for a particular company. In contrast, an increasing proportion is coming from actors trading for mostly technical reasons. This is not necessarily a bad thing for the utility of investors if it better matches them with returns having the particular characteristics they seek or if it improves overall market liquidity. But it likely means that there are fewer trades informed by intrinsic valuations based upon traditional discounted cash flow techniques.

Changing composition of market volume



Sources: 1995 data are estimated based on firms making markets at the time, Investment Co Institute data on fund assets. 2020 data from ModernIR models.

Source: Modern market structure: a survey of the US stock market.

In the past, the dominance of bottom-up, fundamental investors meant that there was always a strong connection between company fundamentals and traded share prices since those fundamentals informed forecasts and thus discounted cash flow valuations. But the growing significance of 'technical' trading weakens the connection between share prices and company fundamentals, amplifying mispricing opportunities.

Charlie Munger argued that valuation had a declining significance for a shareholder's investment return the longer an investment is held. In 1994, he delivered a speech at the University of Southern California Marshall School of Business, saying: *"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return - even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive-looking price, you'll end up with one hell of a result."*

Munger's observation was that if one is going to own a business for the long-term, it is more important that it is a good one rather one that was just cheap when it was bought. We would strongly agree.

If that is the case then, why should fundamental, bottom-up investors even care about valuation? Why not just identify and own high-returning companies for the very long term and ignore market volatility and the actions of non-fundamental based market actors?

Although it sounds tempting, such a strategy would not protect the investor from market volatility. Public markets valuations differ to private, so investors would need the patience to look through periods where public market valuations diverge from fundamentals.

Such patience is rarely infinite. But perhaps more importantly, we believe it is always right to try and maximise investment returns – a belief that is also consistent with our fiduciary duty. That means that owning an investment is always an active decision, weighed against the potential return of an alternative opportunity. The return of that alternative opportunity may be:

1. A company with a higher underlying return on capital.
2. A company with a similar return on capital but bought at a price lower than its intrinsic value, giving an additional return premium.
3. A company with a lower return on capital but with high additional return premium from buying significantly below intrinsic value.

Of these three, we agree with Mr Munger that upgrading the quality of a portfolio by considering a higher returning company makes a lot of sense (case 1, above). Our Competitive Dynamics framework helps us in this. By considering the extra-financial inputs that go into a business that ultimately deliver the accounting returns we are able to identify businesses where returns are sustainable and increasing, under-writing our long-term investment return expectations. It also helps us avoid or divest from businesses with deteriorating Competitive Dynamics where future returns may be falling.

We also note that, because the extra-financial inputs are poorly explained by traditional financial reporting, other market actors may persistently under-appreciate the intrinsic value of a business with strong Competitive Dynamics. This should enhance overall returns by allowing us to capture not only the long-term return on capital of the business but also an arbitrage from this under-valuation (case 2).

We are much less enthused by investment opportunities where the investment return is driven by perceived under-valuation and less by the sustainable quality of the underlying business (case 3). Such an approach is risky as it favours short holding periods and a catalyst to close the gap between intrinsic and market value to be successful. If there is no catalyst and the investment is held for the long-term, the overall return will decline towards the return on capital of the firm. Short-holding periods also create re-investment risk. We prefer to leave such opportunities to quantitative strategies and high-frequency traders.

Whereas the first approach of owning a high returning business has the potential to add value with declining influence from valuation over the long-term, valuation-led arbitrage gains are an important component of the second.

But the opportunity to enhance returns by capturing an arbitrage profit will only be rewarded if the arbitrage closes. This means that although active stock-pickers might be correct in their expectations and have workings that *prove* the intrinsic value, if other investors – passive, fast trading or risk managing – have different expectations and motivations, their weight of money may prevent the arbitrage from closing for an extended period. Indeed, the meme-stock phenomenon of 2020/21 is an example of the weight of investor capital successfully driving market value away from the intrinsic in particular stocks, such as Gamestop or AMC Entertainment.

This is a challenge for active stock-pickers. On the one hand the theoretical opportunity to add value from identifying market mis-pricings increases if company market valuations diverge from intrinsic valuations further for longer. This should create more opportunity to add investment alpha.

"We would argue that this makes owning great businesses with strong Competitive Dynamics even more important."

On the other hand, that additional investment alpha from buying a business at a price less than its intrinsic value may take an indeterminate time to be realised if the weight of technical trading means that market conditions are not supportive. Even a strategy of just owning high return on capital businesses for the long-term may see greater return variability if technical trading interferes with the recognition of fundamental value.

Fundamental, bottom-up investors have consequently had to sharpen their skills. It may no longer be sufficient to 'prove' a valuation and leave market action to deliver the arbitrage gain; valuations will need to be 'justified' too.

We would argue that this makes owning great businesses with strong Competitive Dynamics even more important. Even if technical trading perpetuates mis-pricings, companies with sustainable and improving returns will be adding fundamental value to a portfolio all the while, under-writing long-term returns. But we are also excited at the increasing alpha opportunity we observe from mis-pricings caused by the growing participation of technical trading and market valuations unjustified by fundamental expectations. Passive strategies will not be able to unlock this potential, giving active investors what could be a long-lasting structural opportunity.

Published September 2025

RE/0278/09/25

RBC BlueBay
Asset Management