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Contrarian Strategies: Swimming Against the Current to Success

Countercyclical funds invest outside the mainstream in undervalued and beaten-down stocks and markets. While their performance is prone to volatility, it is consistently remarkably strong. Investors seeking greater independence from index heavyweights should take a closer look at these funds.

The meteoric rise of megacaps in recent years has posed major challenges for most active managers. The rally in large-cap technology stocks—centered on the “Magnificent Seven”—and the resulting concentration risk make it all the more difficult for active fund managers to outperform their benchmark indices. Managers of countercyclical strategies take a completely different approach. Rather than buying the stocks that are currently in vogue, they buy the ones that others are ignoring. In doing so, they sometimes stray far from their benchmarks—and have often enjoyed great success as a result.

How Contrarian Investors Beat the Market

Several contrarian strategies have significantly outperformed their benchmarks this year. For example, the Fidecum Contrarian Value Euroland rose 21.5 percent from the start of the year through the end of August, significantly outperforming its benchmark index, the Euro Stoxx 50, which gained 14.5 percent. The Evli Hannibal fund, which has only recently become available in Germany, has even posted a gain of more than 30 percent since the start of the year, outperforming the index by 20 percentage points.

One of the best-known contrarian fund managers is Peter E. Huber, portfolio manager at Taunus Trust. His mixed fund, Huber Portfolio, invests globally in high-quality stocks and turnaround opportunities, but also utilizes bonds of all types, gold mines, and other commodity stocks, as well as currencies and derivatives. Following his “Three U’s Rule,” Huber invests in stocks that are unpopular, undervalued, and underrepresented in investment portfolios. Countercyclical investors are convinced that while the market regularly overreacts—both upward and downward—stocks and entire markets return to fundamentally fair valuations over the medium term. Of course, every stock undergoes a thorough fundamental analysis, because not every cheap stock is necessarily a good stock.

Greater Volatility Means Bigger Potential

The fact that many of these strategies have performed as strongly as they have recently in a market driven by just a few large stocks is precisely because they do not invest in second-tier stocks—which are also performing well but slightly less so—as many other funds do. Instead, they actually invest in stocks that are strikingly undervalued for various reasons. Petter Langenskiöld, a fund manager at Evli Hannibal, says: “When market dynamics are heavily concentrated in just a few sectors or styles, other sectors come under disproportionate pressure—simply because they’re not in line with the trend.” According to the fund manager, this

creates attractive entry opportunities for contrarian investors. Of course, these come at a price: “Higher volatility in the short term, which, however, usually evens out over longer periods.”

Another characteristic of contrarian approaches is their significant deviation from the index. For the Fidecum Contrarian Value Euroland, the tracking error is approximately 13.2 percent relative to the Euro Stoxx 50, and volatility, at 22.7 percent, is significantly higher than the index’s 15.5 percent. The key metrics for other contrarian strategies are similar. The Fidelity Fast Global Fund goes a step beyond traditional contrarian investing: It not only takes “long” positions in stocks that the fund manager views positively, but also takes “short” positions in stocks and markets where the outlook is negative. Under normal market conditions, the typical range for net market exposure is 90 to 110 percent of the subfund’s total net assets.

Different mix of stocks and regions in the portfolio

The differences from the more conventional, benchmark-oriented strategies become apparent at first glance at the portfolio: The top holdings in the contrarian portfolios consist of stocks that are quite different from those in most equity funds, where—depending on the region—large U.S. stocks such as Nvidia and Microsoft, or in Europe, ASML, SAP, or LVMH, top the list. By way of comparison: The largest long positions in Fidecum’s European strategy include Deutsche Bank, the utility company ENI, and Renault; in MFS’s strategy, the Italian beverage manufacturer Davide Campari-Milano; and in Evli Hannibal’s strategy, HK Foods and Salzgitter alongside Vodafone and Volkswagen. In the global Huber Portfolio, the largest equity weightings after bonds, gold, and silver are Alibaba stock and a value-oriented emerging-market ETF.

The focus on undervalued stocks also diversifies the regional allocation. U.S. stocks, which account for more than 70 percent of the MSCI World Index, are significantly underweighted here due to high valuations: Fidelity’s Fast Global Fund invests just 10.7 percent in the U.S., compared with 24.1 percent in the U.K. and 14.8 percent in China. The picture is similar at Taunus Trust: When Peter Huber analyzes the markets, he is concerned about high valuations in the U.S. as well as in Europe. Overall, Huber says, it is currently becoming increasingly difficult to find attractive stocks. He currently finds favorable valuations primarily in Asia, and especially in China, where stock prices have plummeted sharply since early 2021. Since hitting a low point about a year ago, however, the MSCI China Index has rebounded by more than 45 percent.

Against the Trend to Success

The Fidecum Fund also illustrates what defines a countercyclical approach: Shares of Deutsche Bank and Salzgitter rose particularly sharply in June, while Renault, on the other hand, struggled amid a change in CEO and a flurry of negative news. The fund management took some profits and further increased its position in the battered Renault stock. A similar pattern is evident with Evli Hannibal: The biggest winners this year are precisely the stocks that had weighed on performance in 2024—such as Thyssenkrupp. Part of the current outperformance is therefore a direct rebound from the previous year’s weakness.

Within the portfolio, contrarian strategies offer more than just an additional source of returns. With their positioning largely independent of the benchmark and against the market trend, they offer excellent diversification benefits, which can be particularly advantageous in the highly concentrated U.S. and global stock markets.

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