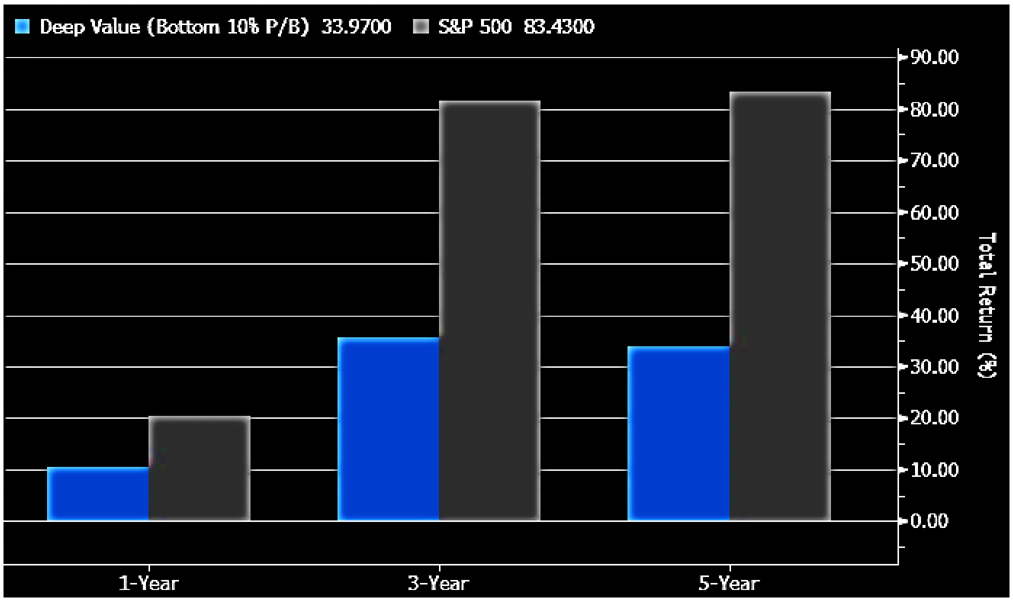
# When Cheap May Be Risky

The Lead | September 2026

## Performance of Cheap Price to Book Stocks
### Deep Value vs. S&P 500 Total Returns




A deep value stock is a company's share trading at an exceptionally steep discount to its intrinsic or asset value. Bottom 10% P/B means a stock's Price-to-Book (P/B) ratio is lower than 90% of other companies in a specific group. It indicates that the stock is highly undervalued relative to its net asset value. Data is as of 08.28.2026. Source: Bloomberg L.P.

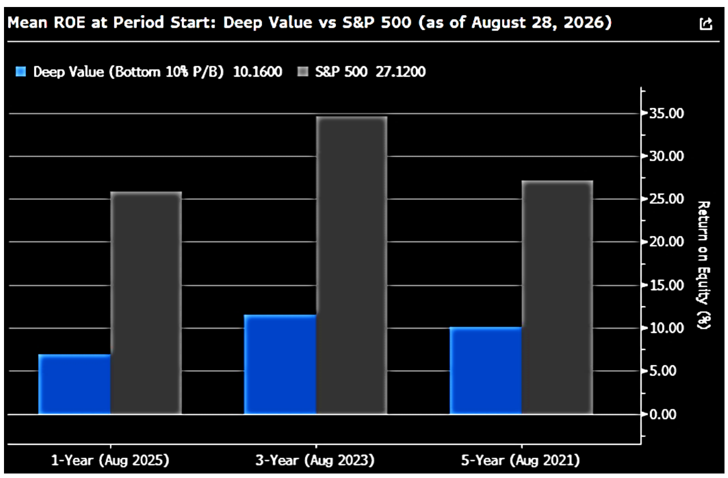
Over the past few years, we have discussed how periods of market weakness can, in certain circumstances, create investment opportunities. This month we have actively debated a recommendation where the primary thesis point was that it was "cheap."

Are we value investors? Yes, but value is but one of our four investment pillars. Our investment philosophy comprises not only value, but considerations such as the competitive advantage a company should have to maintain and grow their return on capital. Also, does the company have excessive debt adding to the risk of the position, and is there a clear path to future growth, or does outlook seem mainly based on the possibility that results will return to historical norms?

What's the point for clients? Stocks that are cheap on valuation may be risk masquerading as a cheapness signal. In this scenario, there seem to be three main problems.

First, if returns on capital for cheap stocks tend to be just above their cost of capital, as seen in the second chart, there appears to be little room for error, hence risk as any growth could destroy value if returns on capital are below their cost.

### Return on Equity Comparison




ROE: Return on equity. Data is as of 08.28.2026. Source: Bloomberg L.P.

Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Charts are for illustrative purposes only.

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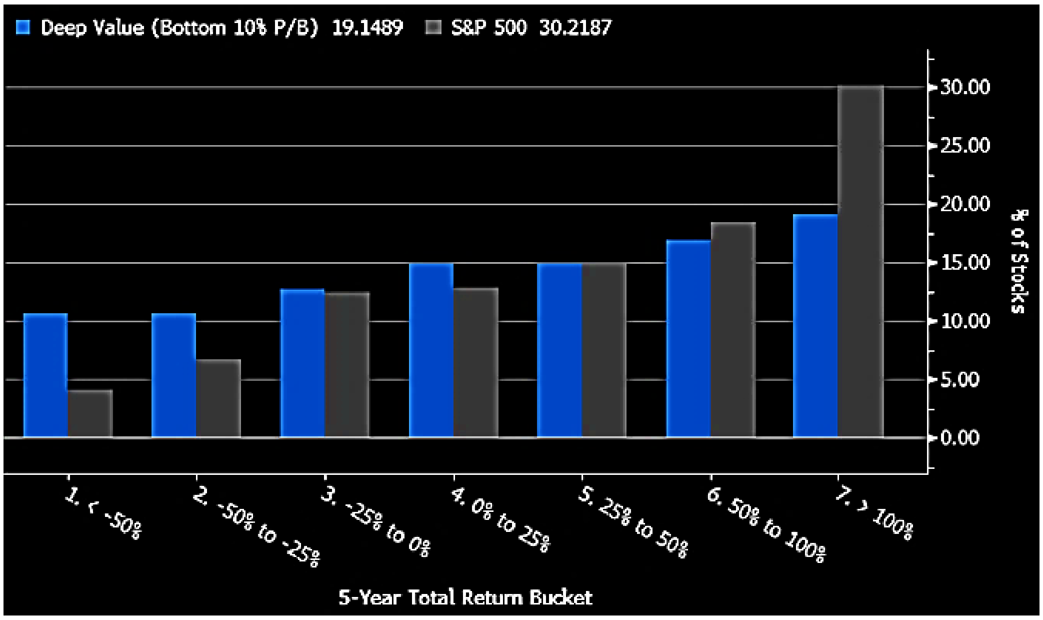
### The Cheapest Stocks on the Five-Year Assessments Generated the Least Returns

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Second, as seen in the chart above, this group of stocks over the past five years has had a negative skew in terms of their risk profile. In other words, the cheapest stocks also appeared to generate weaker returns than the market over this period. We believe this may have contributed to their overall pattern of underperformance as seen above.

Finally, how long is an investor willing to wait for the potential classic revision to the mean to occur?

By focusing on our four pillars, rather than just one, we aim to minimize these concerns in our investment decisions. By focusing on companies with higher-than-average returns on capital, we seek to minimize the risk of not earning our cost of capital.

In terms of timing, while the value-only investor appears to wait for an event to close the gap between the share price and their view of intrinsic value, companies with high returns on capital may be better positioned to compound value year after year. Quality stocks are seldom cheap, and many times periods of unfavorable news may create opportunity. But in scrutinizing new investment opportunities, we believe that work needs to be done not just in valuation, but valuation combined with the quality of the business that can be owned over a long period of time.

As always thank you for your interest and trust managing your investments.

**Charles J. Wittmann, CFA®**, Executive Director, joined Sterling Capital Management in 2014 and has investment experience since 1995. Chip is Co-Portfolio Manager of the Equity Income strategy. Prior to joining Sterling, he worked for Thompson Siegel & Walmsley as a portfolio manager and (generalist) analyst. Prior to TS&W, he was a founding portfolio manager and analyst with Shockoe Capital, an equity long/short hedge fund. Chip received his B.A. in Economics from Davidson College and his M.B.A. from Duke University's Fuqua School of Business. He holds the Chartered Financial Analyst® designation and served as President of CFA Society Virginia from 2012-2013.

# Important Information

## Disclosures

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Since we began publishing The Lead in 2015, our primary purpose has been to communicate our investment philosophy and process as an investment advisor in the context of changing markets. In creating portfolios that differ from our benchmarks by focusing on characteristics that have a long-term history of attractive relative returns according to Ned Davis Research, the portfolios are different from the benchmarks and as a result there can be periods where results differ including below benchmark performance. Since strategies are oriented toward the long-term characteristics, if those characteristics are out of favor over a period of time, the given strategy's performance could be challenged in terms of relative performance. While Sterling believes active professional investment management that employs a consistent process with a long-term orientation and aligned with client interests offers benefits, management fees to support the active approach can be higher than certain alternatives. When hiring an investment manager, we believe it is important to monitor the investment risks taken including sector concentrations, portfolio turnover, and the impacts of dividend policy changes.

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