



Investment Perspectives

Equities: Exploring Quality Metrics in Value Stocks

Portfolio Manager, John Hardy, explains what represents quality in value investing today.



John Hardy, *Senior Managing Director & Portfolio Manager*

KEY TAKEAWAYS

- Higher interest rates have re-anchored markets around fundamentals, making quality and cash flow matter again.
- Modern value investing looks beyond traditional metrics, focusing on free cash flow and capital discipline in a higher cost of capital world.
- Market volatility and artificial intelligence (AI)-driven disruption could create opportunities where consensus expectations may be wrong.

With interest rates closer to historical norms and capital once again carrying a real price, the current environment has restored differentiation between companies with durable cash flows and those dependent on easy financial conditions. Here, we explore the importance of quality equities and the metrics active managers use to help identify opportunities in the space.

Why has quality become so important for value stocks in a higher-rate world?

When rates were near zero, the penalty for poor capital allocation decisions was much lower, and the performance gap between companies that made money and those that didn't narrowed as valuations expanded across the market.

With interest rates at today's levels, companies must earn well above their cost of capital to create a cushion that allows them to reinvest in their businesses or return capital to shareholders through buybacks. When rates were near zero, the distinction between companies that made money or not had much less impact on stock performance. Since rates began rising in 2021, however, the performance gap between profitable and unprofitable companies has widened significantly, creating potential opportunities for active investors to distinguish between the two with a focus on quality and discipline.



How does the growth of AI fit into a value investing framework?

Investor concerns around AI have increasingly focused on which industries and sectors could be disrupted by its adoption. The bigger source of confusion, however, is identifying who ultimately benefits. The value team views it through the same top-down framework applied to other structural shifts across industries, whether they unfold at a micro or macro level. Within that framework, companies can be categorized into four groups:

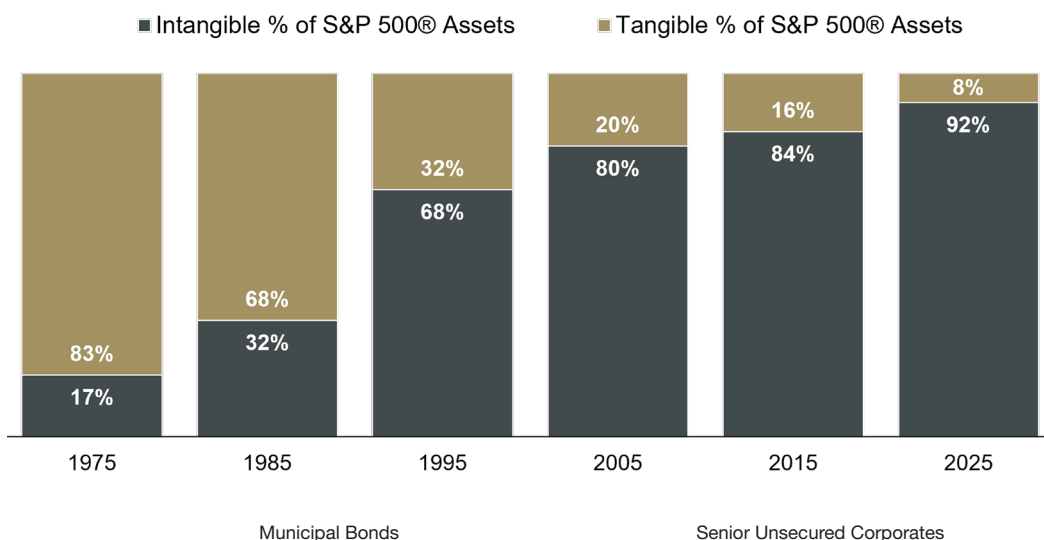
- 1) Companies that both we and the market believe will benefit from AI. These businesses are typically fairly valued or even expensive, reflecting broad consensus around their upside.
- 2) Companies the market expects to benefit from AI, but where we disagree. These are companies we avoid, as we do not see the anticipated gains materializing.
- 3) Companies that both we and the market believe will be negatively impacted by AI. These are generally uninteresting from an investment standpoint.
- 4) Companies the market believes will be harmed by AI, but we see opportunity. This is where we are spending the most time today, as misperceptions around AI's impact may be creating attractive entry points.

This final group, where market expectations appear misaligned with fundamentals, is where we believe active investors have the greatest opportunity to add value.

What is a modern value equity view of valuation and risk management?

Traditional measures like price to book once defined value, but as intangible assets have become a larger driver of returns, those metrics have lost relevance (see Figure 1).

Figure 1. Company Balance Sheets Have Changed with the Technology Boom



Source: Kenneth French data library at Dartmouth as of 2/28/2026. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. **Past performance is not a reliable indicator or guarantee of future results.**



Today, valuation looks beyond surface-level “cheapness” to fundamentals such as:

- **Free cash flow**—the capital a company can reinvest or return to shareholders
- **Capital requirements**—the amount of capital required to generate earnings
- **Earnings durability**—the durability of returns across economic cycles

A stock may appear inexpensive, but without strong cash generation and reasonable capital intensity, it may offer little true value. Risk management is embedded directly into the selection process, rather than reacting after purchase. It emphasizes systematic assessments of quality, fundamental stability to avoid value traps—a stock that looks cheap based on traditional valuation metrics but stays cheap, or gets cheaper, because the underlying business is deteriorating—and portfolios driven by stock-specific insights rather than macro bets.

Looking Ahead

Large parts of the economy have experienced only modest growth since the COVID-19 pandemic. Manufacturing activity, housing, and select cyclicals remain subdued, suggesting the next phase may not begin from a place of excess. In that backdrop, maintaining a quality bias toward leverage and cash flow remains critical. For disciplined value investors, the current mix of normalized rates, uneven growth, and innovation-driven disruption may offer a more balanced opportunity set where active investors can thrive.



Glossary & Index Definitions

Cost of capital is the minimum rate of return a company must earn on its investments to satisfy its providers of capital (both debt and equity investors).

Fama-French: In 1992, Eugene Fama and Kenneth French released their influential research on how to define value companies, growth companies, and the high-minus-low (HML) factor, which showed, historically, how value companies had outperformed growth companies, i.e., the value premium. Value companies were defined as companies with lower price-to-book values (P/B), while growth companies had higher P/B ratios.

Free cash flow (FCF) represents the amount of cash generated by a business, after accounting for reinvestment in non-current capital assets by the company. **Normalized free cash flow** attempts to smooth out a company's FCF by excluding non-core operations and one-time items.

Growth/Value Investing: Growth stocks may be characterized as equities of companies that have demonstrated better-than-average gains in earnings in recent years and that are expected to continue delivering high levels of profit growth. Growth equities typically carry higher price-to-earnings multiples than the broader market, high earnings growth records, and greater volatility than the broader market. **Secular growth stocks** are stocks of companies whose economic performance is relatively immune to economic cycles.

Value stocks may be characterized as equities of companies that have fallen out of favor with investors but still have good fundamentals, or new companies that have yet to be recognized by investors. Value stocks typically feature lower price-to-earnings multiples than the broader market, and often industry peers, and somewhat lower volatility than the overall equity market.

Market capitalization: The U.S. Financial Industry Regulatory Authority, or FINRA, defines the following categories of stocks based on their market value: mega cap stocks, \$200 billion or more; large cap stocks, between \$10 billion and \$200 billion; mid cap stocks, between \$2 billion and \$10 billion; small cap stocks, between \$250 million and \$2 billion; and micro cap stocks, less than \$250 million.

The **price-to-book ratio** compares a company's market value to its book value. The market value of a company is its share price multiplied by the number of outstanding shares. The book value is the net assets of a company.

Price-to-earnings ratio: Stock analysts calculate a price-to-earnings ratio by dividing a stock's current price by its earnings per share on a trailing 12-month basis. A forward price-to-earnings ratio is calculated by dividing a stock's current price by estimated future earnings per share.

Tangible assets are assets with a physical form and that hold value. Examples include property, plant, and equipment. **Intangible assets** lack physical substance and include patents, copyright, franchises, goodwill, trademarks, and trade names.

A **top-down** investment process generally places more emphasis on macroeconomic forecasts than on individual stock picking. A bottom-up approach typically relies on selecting individual securities as the primary driver of investment returns.

Value trap refers to a stock that appears to be attractively priced based on company fundamentals and the stock's market price but ultimately provides either a negative or subpar return.

Important Information

The information contained herein is provided by Lord, Abbett & Co. LLC ("Lord Abbett"). Lord Abbett is a registered investment adviser under the U.S. Investment Advisers Act of 1940 (the "Advisers Act"), as amended, and is subject to the Advisers Act rules and regulations adopted by the U.S. Securities and Exchange Commission ("SEC"). Registration with the SEC does not imply a particular ability or training. Lord Abbett is a global asset manager with headquarters in Jersey City, New Jersey.

Certain information provided in the material has been obtained from third party sources and such information has not been independently verified by Lord Abbett. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information by

Lord Abbett or any other person. While such sources are believed to be reliable, Lord Abbett does not assume any responsibility for the accuracy or completeness of such information. Lord Abbett does not undertake any obligation to update the information contained herein as of any future date.

Certain information contained in the material constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events, results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Nothing contained in the material may be relied upon as a guarantee, promise, assurance or a representation as to the future.

Market forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

Past performance is not a reliable indicator or guarantee of future results. All investments involve risk, including the loss of capital.

The views and opinions expressed are those of the Lord Abbett author as of the date of the material, and do not necessarily represent the views of the firm as a whole. Any such views are subject to change at any time based upon market or other conditions and Lord Abbett disclaims any responsibility to update such views. References to specific asset classes and financial markets are for illustrative purposes only. This material is not intended to be relied upon as a forecast, research or investment advice. Neither Lord Abbett nor the Lord Abbett author can be responsible for any direct or incidental loss incurred by applying any of the information offered.

The information in this material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation in any jurisdiction. This material has not been reviewed or approved by any regulatory authority in any jurisdiction.

None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity.

Mentions of specific companies are for reference purposes only and are not meant to describe the investment merits of, or potential or actual portfolio changes related to, securities of those companies.

Unless otherwise noted, all discussions are based on U.S. markets and U.S. monetary and fiscal policies.

Data on higher interest rates raising the cost of capital for businesses sourced from the U.S. Federal Reserve.

This material may not be reproduced in whole or in part or any form without the permission of Lord Abbett.

Important Information for non-U.S. Investors

Note to Switzerland Investors: In Switzerland, the Representative is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the Paying Agent is Bank Vontobel Ltd., Gotthardstrasse 43, CH-8022 Zurich. The prospectus, the key information documents or the key investor information documents, the instrument of incorporation, as well as the annual and semi-annual reports may be obtained free of charge from the representative. In respect of the units offered in Switzerland, the place of performance is at the registered office of the representative. The place of jurisdiction shall be at the registered office of the representative or at the registered office or domicile of the investor.

Note to European Investors: This communication is issued in the United Kingdom and distributed throughout the European Union by Lord Abbett (Ireland) Limited, UK Branch and throughout the United Kingdom by Lord Abbett (UK) Ltd. Both Lord Abbett (Ireland) Limited, UK Branch and Lord Abbett (UK) Ltd are authorized and regulated by the Financial Conduct Authority.



A decision may be taken at any time to terminate the arrangements made for the marketing of the Fund in any EEA Member State in which it is currently marketed. In such circumstances, Shareholders in the affected EEA Member State will be notified of this decision and will be provided with the opportunity to redeem their shareholding in the Fund free of any charges or deductions for at least 30 working days from the date of such notification.

Lord Abbett (Middle East) Limited is authorised and regulated by the Dubai Financial Services Authority (“DFSA”). The entire content of this document is subject to copyright with all rights reserved. This research and the information contained herein may not be reproduced, distributed or transmitted in any jurisdiction or to any other person or incorporated in any way into another document or other material without our prior written consent. This document is directed at Professional Clients and not Retail Clients. Any other persons in receipt of this document must not rely upon or otherwise act upon it. This document is provided for informational purposes only. Nothing in this document should be construed as a solicitation or offer, or recommendation, to acquire or dispose of any investment or to engage in any other transaction. Nothing contained in this document constitutes an investment, an offer to invest, legal, tax or other advice or guidance and should be disregarded when considering or making investment decisions.

Note to Singapore Investors: Lord Abbett Global Funds I plc (the “Company”) and the offer of shares of each sub-fund of the Company do not relate to a collective investment scheme which is authorized under Section 286 of the Securities and Futures Act, Ch. 289 of Singapore (“SFA”) or recognized under Section 287 of the SFA, and shares in each sub-fund of the Company are not allowed to be offered to the retail public. Pursuant to Section 305 of the SFA, read in conjunction with Regulation 32 of and the Sixth Schedule to the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (the “Regulations”), the Lord Abbett Global Multi-Sector Bond Fund, the Lord Abbett High Yield Fund, the Lord Abbett Short Duration Income Fund, the Lord Abbett Ultra Short Bond Fund, the Lord Abbett Climate Focused Bond Fund, the Lord Abbett Emerging Markets Corporate Debt Fund and the Lord Abbett Multi

Sector Income Fund have been entered into the list of restricted schemes maintained by the Monetary Authority of Singapore for the purposes of the offer of shares in such sub-funds made or intended to be made to relevant persons (as defined in section 305(5) of the SFA), or, the offer of shares in such sub-funds made or intended to be made in accordance with the conditions of section 305(2) of the SFA. These materials do not constitute an offer or solicitation by anyone in Singapore or any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation.

Note to Hong Kong Investors: The contents of this material have not been reviewed nor endorsed by any regulatory authority in Hong Kong. An investment in the Fund may not be suitable for everyone. If you are in any doubt about the contents of this material, you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser for independent professional advice. The Fund is not authorised by the Securities and Futures Commission (“SFC”) in Hong Kong pursuant to Section 104 of the Securities and Futures Ordinance (Cap 571, Laws of Hong Kong) (“SFO”). This material has not been approved by the SFC in Hong Kong, nor has a copy of it been registered with the Registrar of Companies in Hong Kong and, must not, therefore, be issued, or possessed for the purpose of issue, to persons in Hong Kong other than (1) professional investors within the meaning of the SFO (including professional investors as defined by the Securities and Futures (Professional Investors) Rules); or (2) in circumstances which do not constitute an offer to the public for the purposes of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32, Laws of Hong Kong) or the SFO. This material is distributed on a confidential basis and may not be reproduced in any form or transmitted to any person other than the person to whom it is addressed.

Copyright © 2026 by Lord, Abbett & Co. LLC. All rights reserved.