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Sticking with Value: Patience and Persistence Required

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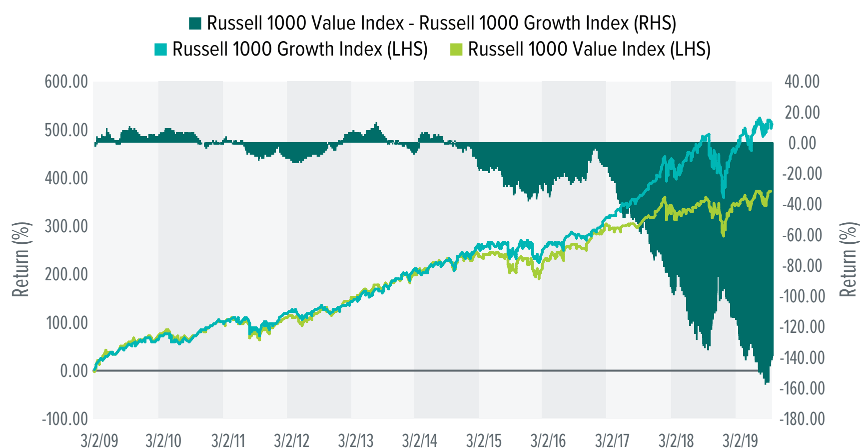
Snapshot

- Over the long run, value investing has generally outperformed the broader market.
- Despite the superior performance of growth stocks over the last 10 years, we need not look far back in history to witness the potential consequences of straying from value.
- We do not believe that growth stocks will always be the only game in town.

Over the long run, value investing has generally outperformed the broader US equity market when it comes to building wealth. Patient investors who have stayed true to a value-minded philosophy over several economic cycles have seen compelling results as the market eventually recognised the underlying worth of the assets.

However, since the end of the global financial crisis in March 2009, the Russell 1000 Value Index has trailed the Russell 1000 Growth Index by about 3% annualised. In periods like this, when a particular area of the market underperforms relative to expectations for several years in a row, some investors are understandably tempted to stray from a commitment to their original philosophy. Exhibit 1 highlights the growing disparity between growth and value.

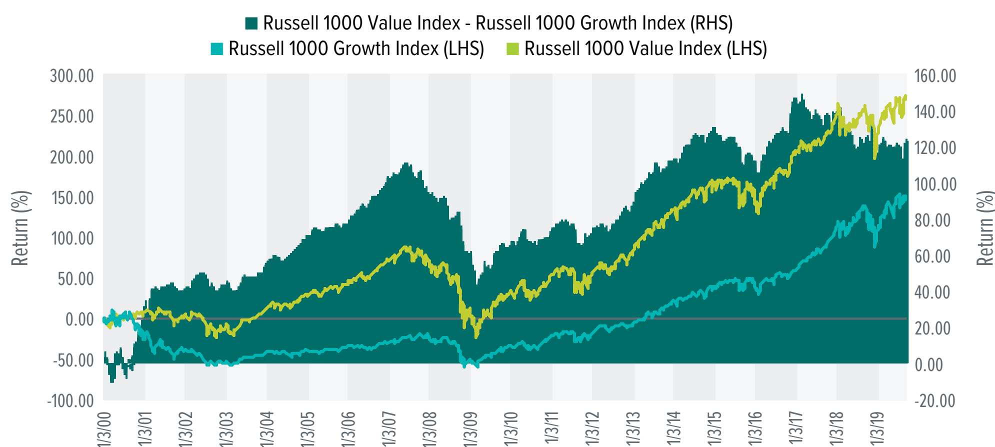
Exhibit 1: Growth Gains Going on 10 Years



Source: Bloomberg, SEI
Data as at 30/9/2019
Past performance is not a reliable indicator of future results.

While value occasionally lagged growth over the last 20 years, value-oriented portfolios recovered each time—at least for investors who stayed the course. Despite the outperformance of growth stocks over the last 10 years, we need not look far back beyond the 10 years to witness the potential consequence of straying from value (as shown in Exhibit 2).

Exhibit 2: Value Remains Resilient



Source: Bloomberg, SEI
Data from 2/1/2000 to 30/9/2019
Past performance is not a reliable indicator of future results.

Between 2000 and 2019, the Russell 1000 Value Index returned 6.9% annually, besting the Russell 1000 Growth Index at 4.7%. Value investors were challenged to remain patient through multiple periods when the benchmark index underperformed its growth counterpart but still came out far ahead over full the 20-year period.

The temptation to believe that "this time is different"—that the benefit of value investing has actually run its course—becomes stronger when the outperformance of growth is fresh in investors' minds. It is especially difficult to keep perspective when the stocks moving the growth index are those that typically receive the most media attention, including some of the larger technology companies.

There have been bouts of relatively concentrated outperformance within mega-cap growth stocks versus the broader US equity market in the past several years. Such periods often raise questions among investors about whether or not there is still a need to include value names in their portfolios. In our view, there is always a need for value exposure.

Whenever we invest in an asset class, our decision is about future opportunities. We think the lofty price of growth stocks currently suggests that near-term upside potential is limited. While it is our belief that value is poised to outperform growth in the future, there is no reliable way to predict how far into the future this shift will occur.

Value seems to be showing signs of a recovery that are still obscured by the continued rise of expensive mega-caps. We therefore believe it's particularly important to be wary of trying to "market time" a catalyst or specific style to be in favour. Although valuation spreads are wide and there should be some reversion to the mean, we think it would still be a stretch to say with certainty that now is the exact time to buy value. Catalysts are often difficult to see or predict. Accordingly, as always, we believe in a diversified approach to investing.

In view of the vast uncertainties facing investors, the "prediction game" is arguably even more challenging than usual. We do not think it best to assume that growth stocks will always be on top—nor do we think investors should attempt a move to value that is perfectly timed with a market shift. Rather, we believe that investors are better positioned for long-term success when seeking a diversified portfolio that encompasses both asset classes, while also taking value's historical long-run outperformance to mind. Recent volatility and sharp style rotations should serve as reminders that trends do not last forever.

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