Sticking with Value: Patience and Persistence Required

JUNE 2020

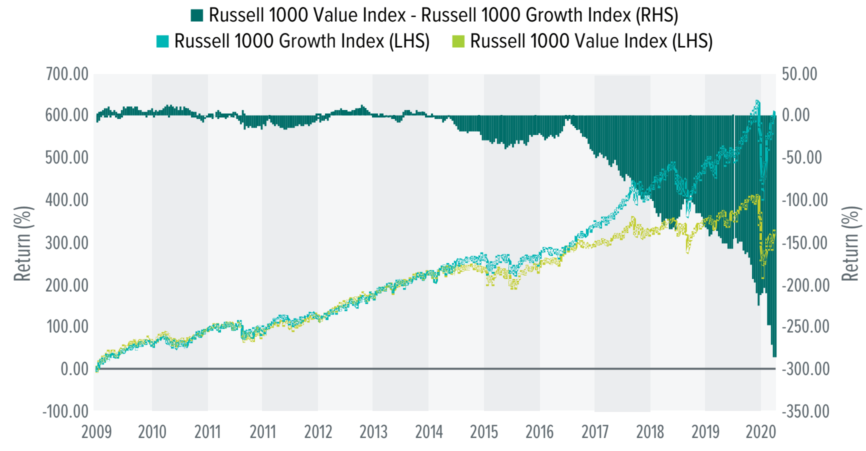
Snapshot

- 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 U.S. 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, in the five-month period ending May 31, 2020, the Russell 1000 Value Index trailed the Russell 1000 Growth Index by over 20%. Since the end of the global financial crisis in March 2009, the Russell 1000 Value Index has lagged the Russell 1000 Growth Index by more than 5% annualised. In periods like this, when a particular area of the market underperforms relative to expectations over a long period of time, some investors are understandably tempted to stray from a commitment to their original philosophy. Exhibit 1 highlights the growing disparity between growth and value over the last several years.

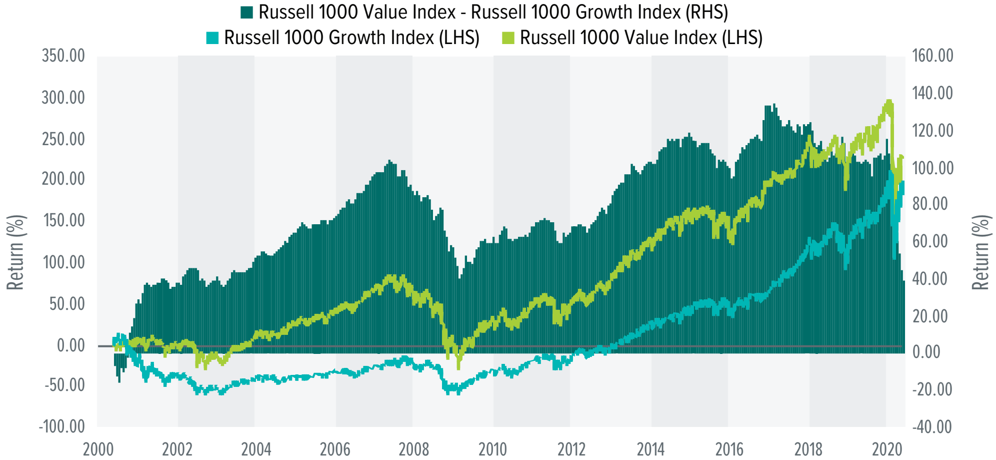
Exhibit 1: Growth Gains Over 10 Years



Source: Bloomberg, SEI. Data spans 3/1/2009-5/31/2020. 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 spans 5/31/2000-5/31/2020. Past performance is not a reliable indicator of future results.

Over the 20-year period ending May 31, 2020, the Russell 1000 Value Index returned 6.1% annually, beating the Russell 1000 Growth Index at 5.4%. Value investors were challenged to remain patient through multiple periods when the benchmark Index underperformed its growth counterpart, but the index still came out 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 U.S. 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. Although value seemed to show signs of a recovery over the last two weeks of May, we believe it's important to be wary of trying to "market time" a catalyst or specific style to be in favour. While 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.

Index Definitions

Russell 1000 Growth Index: The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index: The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

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