MARKET MINUTE
WITH McGAREL

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The outperformance of value stocks over growth stocks has been well documented over the last 90 years [Chart 1]. However, if you had only invested in value stocks based on this history over the last 15 years, you wish you had never seen this chart.

From 2007 until the end of 2021, 15 calender years, the S&P 500 Value Index ("Value Index") outperformed the S&P 500 Growth Index ("Growth Index") in only 3 years. One year was essentially a tie. And the remaining 11 years saw growth beat value. Moreover, the cumulative total return during that period was 356% for the S&P 500 Index, while the Growth Index returned 553% and the Value Index returned only 199%. A complete rout.

It's no wonder the recent rally off the bottom on June 16, 2022 until the end of July 2022 saw the Growth Index return 17.1 % and the Value Index return only 8.9%. Investors have been conditioned over the last 15 years that growth stocks are the only place to look for outperformance. But maybe it's time to question the idea that value can only outperform in brief windows and is not sustainable over a much longer period. After all, the chart below shows a pretty dominant picture of value over growth for a lot longer than just 15 years.

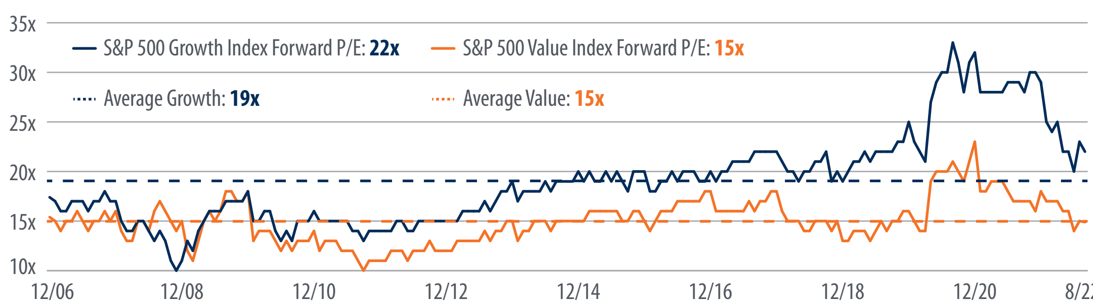
Then consider the reason for the massive outperformance of growth over value over the last 15 years. Certainly growth companies have had superior earnings growth over that span of time. We know earnings drive stock prices. However, the other significant driver of the excess performance of growth stocks over value stocks is less objective. Simply put, investors have now assigned much higher earnings multiples to growth stocks while actually decreasing the multiples for value stocks. At the end of 2006, the Growth Index traded at 17.4 times forward earnings and the Value Index at 15.4 times. On August 31, 2022, the Growth Index traded at 21.7 times forward earnings and the Value Index at 14.9 times [Chart 2]. The S&P 500 Pure Growth Index (25x) versus the S&P 500 Pure Value Index (11x) trades at even wider spreads today. Multiple expansion or contraction is a product of forecasting future growth prospects. However, history tells us investors' forecasts are typically informed by past performance despite their insistence they are looking forward. This hindsight bias may have driven the valuations too high for growth and too low for value. This may be especially true today as a very different economic environment is unfolding. At a minimum, higher inflation and higher interest rates suggest a slowing of earnings growth in the future and that may be the cause for the valuation spread between growth and value stocks to contract and narrow similar to 2006 levels. In that scenario, whether stocks go up or down, value would be the outperformer.

Chart 1: Value Factor (P/B) Performance Through the Decades

Decade	Top-Decile Value	Top-Decile Growth	Excess Return
1930	-9.4%	-0.1%	-9.4%
1940	18.0%	6.4%	11.6%
1950	20.4%	19.5%	0.9%
1960	10.5%	8.4%	2.1%
1970	14.6%	1.6%	13.0%
1980	23.8%	11.6%	12.2%
1990	17.9%	20.3%	-2.4%
2000	4.9%	-3.6%	8.4%
2010	8.3%	16.2%	-7.8%

Source: Kenneth R. French data library using the CRSP database. Universe includes all NYSE, AMEX & Nasdaq stocks. Stocks are market cap weighted.

Chart 2: S&P 500 Growth Index vs. S&P 500 Value Index Forward P/E Ratios



Source: Bloomberg. Monthly data is calculated from 12/29/06 - 8/31/22.

Past performance is no guarantee of future results.

All charts are for illustrative purposes only and not indicative of any actual investment.

Forward P/E is calculated by taking the price divided by next twelve months earnings per share.

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