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Monthly Insight

"Rumors of My Demise Are Greatly Exaggerated": Value Stocks and the Patient Investor

Many readers will recognize the pithy quote from Mark Twain in the title of this article. But many readers may also be wondering, given the extreme duration of the current underperformance of value stocks, whether it might at last be time to hold a funeral for value investing.

The market bottomed out from the Great Recession in 2009, and since then both value and growth stocks have posted positive performances. Nevertheless, value stocks have generally continued to lag growth stocks. In 2017, growth stocks in the S&P 500 like Amazon and Apple outpaced value stocks like Exxon Mobil and Macy's at a 12% rate. In 2018, growth beat value by just over 7%, and growth led value by about 10% in 2019 (as measured by comparing the Russell 1000 growth and value indexes, respectively). In fact, this trend goes back much farther; for the 10-year period ending in 2019, the value premium (annualized return on value stocks minus annualized return on growth stocks) was negative. Growth beat value every year.

However, this is not the first time that growth has held the upper hand over value for an extended period. In the mid- to late 1990s, growth stocks (one of the leaders at the time was Yahoo! Inc.) were exhibiting skyrocketing prices like we had never before observed. Weston Wellington, vice president of Dimensional Fund Advisors, wrote in an article analyzing the period that "in 1999 … value trailed by the largest calendar year margin in the history of the Russell indices—over 25%." As the trend continued, value investors became increasingly disgruntled, and a wave of redemptions at a well-respected large-cap value fund led to the firing of the fund manager.

And then came March 31, 2000. Beginning on that date and continuing until February 28, 2001, the performance of value stocks roared past growth stocks, topping them by almost 40%. This, like many similar instances in the equity markets, should remind us that even a longstanding trend can turn relatively quickly. We can couple this with the additional observation that predicting exactly when such a reversal will occur is practically impossible. By keeping these two pieces of market wisdom in mind, we are reminded of the value of diversification. Rather than placing all their bets on a single sector—like growth—prudent investors maintain exposure to multiple market segments, realizing that at any given time, one or the other may

outperform.

In a recent column, Jason Zweig, author and personal finance columnist for *The Wall Street Journal*, observed that while growth stocks may be the darlings now, as they have been for a good while, such will not always be the case. He makes the interesting analogy that the stock market is currently like a giant store where people turn up their noses at the bargain-bin merchandise (value stocks) while fighting with each other to get at the costliest offerings (growth stocks). His takeaway is that the current bidding war for growth stocks will inevitably end, and investors will rediscover the attractive logic of “Buy straw hats in the winter,” an old Wall Street proverb that’s usually credited to financier Russell Sage (1816–1906).

Zwieg may have a good point. In fact, research bears him out. Analysts at Dimensional Fund Advisors crunched the numbers on the results of value investing for the last 94 years—from 1926 to the present—and they found something interesting. While it is impossible to predict exactly how long any particular period of underperformance in value stocks will last, the frequency of positive returns has historically increased as time horizons grew longer. For example, when the time interval goes from 5 to 10 years, the frequency of positive returns on value stocks increased from 75% to 84%. In other words, the longer the horizon, the better the chance that value stocks will outperform growth stocks.

This may mean that investors holding value stocks are more likely to have their patience rewarded the longer they hold the assets. Certainly, while a positive value premium can never be guaranteed for any particular year or even any particular span of years, value investors have generally experienced positive returns over time. Value stocks may be the underdogs now, but eventually, they are likely to move to the head of the pack.

Investors who keep their portfolios balanced among different asset classes and different characteristics—including growth, value, large and small capitalization, and other dimensions—may usually expect lower overall volatility and more dependable growth over time. Because it is impossible to predict exactly when or how quickly value investing will catch up with or surpass the performance of growth stocks, maintaining exposure to as many sectors as possible allows patient investors to benefit from a variety of scenarios. This means that strategic portfolio design, diversification, and disciplined rebalancing will continue to increase most investors' chances of long-term success.

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