

# EQUIUS ASSET CLASS<sup>SM</sup>

Modern asset class investing principles, research, and perspectives for long-term investors

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## Perspective on Value

Jeff Troutner, Equius Partners

The ink had hardly dried on last month's *Asset Class* ("Is It 1999 All Over Again?") when I saw this headline:

[Value Investors Face Existential Crisis After Long Market Rally.](#)

—*The Wall Street Journal*, June 4, 2018

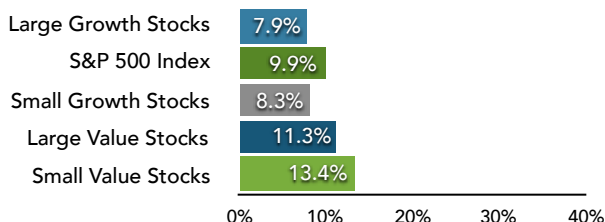
Besides the provocative title, one sentence in the article represents the times we're in and how eerily similar they are to the market environment of 18 years ago: *Value stocks ... have been stuck in a rut for most of the nine-year rally in U.S. stocks.*

There's more to the article, and I encourage you to read it if you have a *Journal* subscription. But the reason I pull out that one sentence is because it represents so well the sentiment of the late 1990s that caused so many investors to abandon balanced, well-diversified portfolios in favor of ones tilted much more heavily to large growth stocks. At that time, the dot-coms dominated. Today it's Facebook, Apple, Amazon, Netflix, and Google.

So if you have any doubt that a more balanced—and therefore value-tilted—portfolio makes sense for you in the long run, or if you believe that we should be shifting your portfolio allocations between growth and value stocks based on recent performance, read on. Otherwise, just set this article aside for future reference. It's the same stuff I've been writing since 1993.

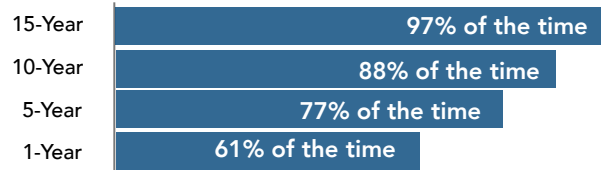
Let's review what we know (all returns are annual).

Chart 1: Value vs. Growth, 1928-2017



Large Growth Stocks = Dimensional US Large Cap High Price-to-Book Index. Small Growth Stocks = Dimensional US Small Cap High Price-to-Book Index. Large Value Stocks = Dimensional US Large Cap Value Index. Small Value Stocks = Dimensional US Small Cap Value Index. Source: Dimensional Fund Advisors. See additional disclosures on back page.

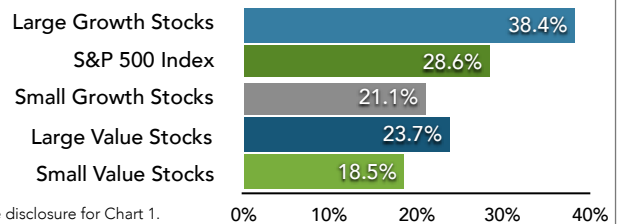
Chart 2: Value Beat Growth



Value is Fama/French US Value Index. Growth is Fama/French US Growth Index. There are 877 overlapping 15-year periods, 937 overlapping 10-year periods, 997 overlapping five-year periods, and 1,045 overlapping one-year periods. Based on rolling annualized returns using monthly data. Rolling multiyear periods overlap and are not independent. This statistical dependence must be considered when assessing the reliability of long-horizon return differences. Source: Dimensional Fund Advisors. See additional disclosures on back page.

So the expected returns and probabilities favor value stocks—over the long term. In the short term, however, anything can and will happen. Let's look at the 1995-1999 period as an example.

Chart 3: Value vs. Growth, 1995-1999



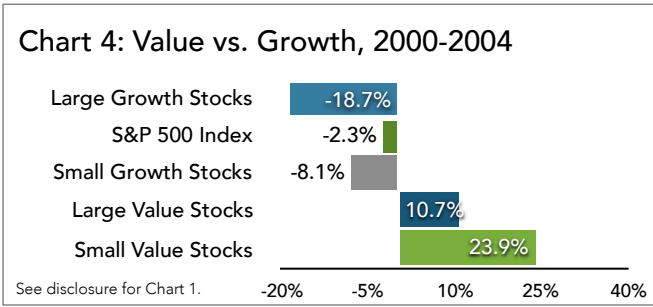
See disclosure for Chart 1.

One thing you should notice when you compare Charts 1 and 3 is that large and small *value* stocks did exceptionally well during the 1995-1999 period—on an absolute basis and compared to historical returns. The challenge at the time (both for us as advisors "selling" against the prevailing "wisdom" and for investors caught up in it) was that large growth stock performance was off the charts.

But the next five-year period was very different, as, in a [March 1999](#) article, we suggested it might be.

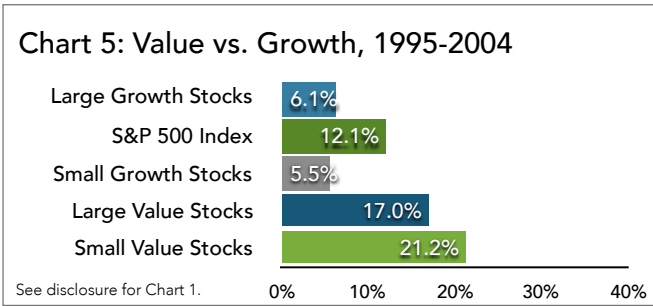
*"Unfortunately, too many investors are being drawn to that 30.3% [1995-1998] return of the S&P 500 and severely overweighting their portfolio toward the one asset class. If the fundamental principles of risk and return and cost-of-capital ever reassert themselves, the cost to these investors could be huge, and will*

most likely be compounded by another reactionary move the other way.” And here’s what happened.

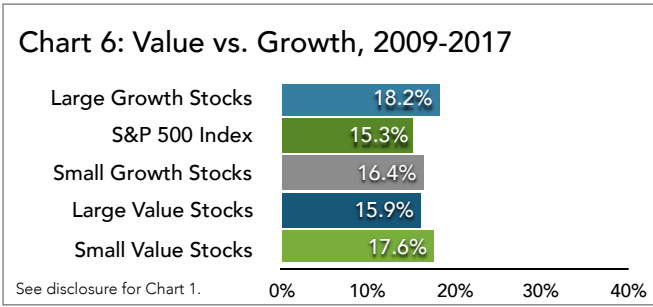


In asset class investing (in contrast to speculative strategies), focusing on short-term periods when investing for the long term is not wise. For too many investors, the reactionary move was into “alternatives” like hedge funds, commodities, and leveraged real estate. We know how those worked out.

You might reasonably wonder whether the massive lead piled up by growth stocks from 1995 to 1999 was enough to overwhelm the performance of small and value stocks in the subsequent five years. Chart 5 shows it was not.



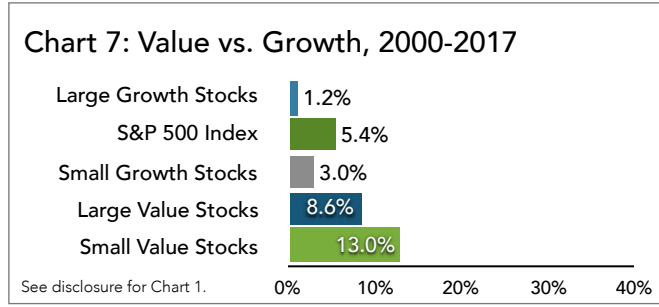
Now let’s turn our attention to the past nine years during which value stocks “have been in a rut.”



Some rut. Once again we see that large and small value stocks have done very well compared to their historical averages, but large growth stocks have performed slightly better. Could these asset class return differences increase to the same extent we saw prior to the dot-com crash? Of course they could, although we think the likelihood is small.

Instead, let’s consider the possibility that eventually small-cap and value stocks—being riskier—will rise to their traditional place in the returns lineup and reward patient investors.

Finally, consider the performance of these asset classes thus far in the 21st century, a period that includes the dot-com crash, the global financial crisis, and the so-called “lost decade.”



### The Tortoise and the Hare

Those of you who have made it this far might be wondering why I’m writing another article on value stocks. Other than correcting the record on what constitutes an investment “rut,” I wanted to give you a preview of a future “The Tortoise & the Hare” article. The ones I wrote in [August 2001](#) and [June 2002](#) were essentially “I told you so” articles meant to reassure clients who—to paraphrase Rudyard Kipling—were keeping their heads when all about them were losing theirs. To be totally sincere, it was also directed at investors who didn’t become Equius clients in the late 1990s because they thought we were in a “new era” and Phil and I were crazy for not jumping on the large growth stock bandwagon.

Equius will continue to tilt portfolios toward small-cap and value stocks for clients with intermediate to long-term investment time horizons who are willing to accept the higher risk and behavioral challenges of owning value stocks.

We will also continue to rebalance portfolios to maintain consistent risk (and the higher expected return that comes with it) while taking advantage of any wild swings in asset class returns in the short run that present a sell-high, buy-low opportunity.

For another perspective on this topic, see Weston Wellington’s article “A Vanishing Value Premium?” from January 2016. It’s posted on our web site here: [www.equiuspartners.com/blog](http://www.equiuspartners.com/blog).

“The Tortoise & the Hare” articles can be found on our web site at [www.equiuspartners.com/newsletter](http://www.equiuspartners.com/newsletter). You can find them by clicking on the year under “View by Year” on the left side of the page.