PERSPECTIVES

VIEWPOINTS FROM THE ACADIAN TEAM

SETH WEINGRAM, Ph.D.

SENIOR VICE PRESIDENT, STRATEGIST

THE DEATH OF VALUE?

ASSESSING VALUE PERFORMANCE IN A HISTORICAL CONTEXT

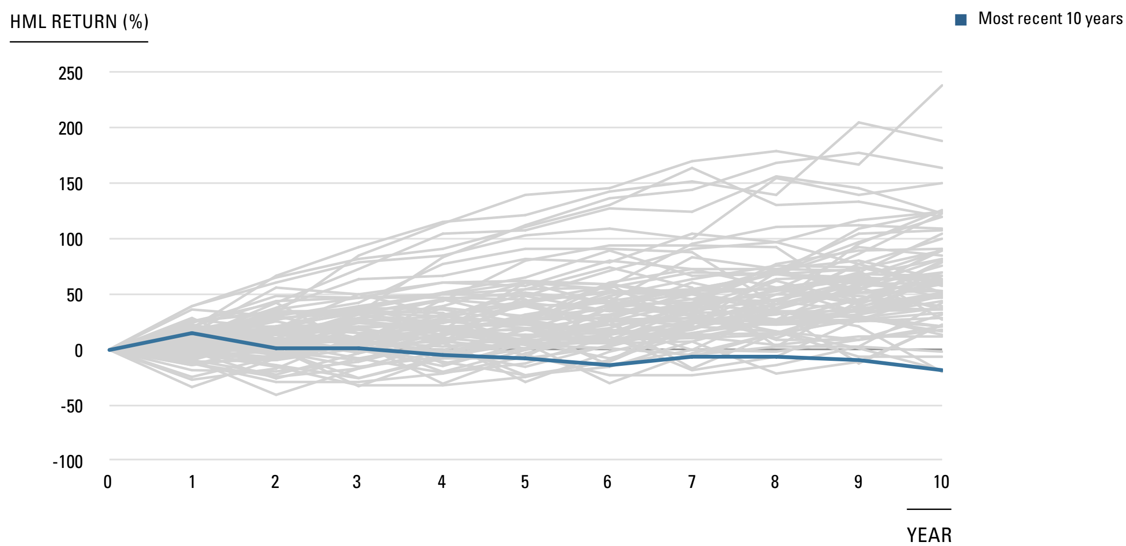
APRIL 2016

In June 2000, *The New York Times* published a story noting sharply reduced attendance at a prominent Columbia University seminar on value investing.[1] Over the prior two years, the MSCI USA Growth index had outperformed its value counterpart by 42%,[2] as waves of investors came to believe that new technologies had changed the world so dramatically that enormous valuations could be justified for companies that had no earnings or even revenue.The *Times* story ran just as the dot-com bubble began to burst. This ended a spectacular run for growth stocks, and ushered in a multi-year period of value strategy outperformance.

Interest in value investing has risen and fallen for decades. We believe that episodic preoccupation with growth stocks—another example being the "Nifty Fifty" period in 1971-72 when a small group of high-perceived-growth companies drove U.S. market performance—helps to explain the long-term excess returns offered by value strategies historically.

FIGURE 1: RECENT VALUE PERFORMANCE IN HISTORICAL CONTEXT*

Ten-year return paths of a hypothetical long-short value-minus-growth portfolio, beginning every January since 1927.



* Calculated from annual "HML" factor returns as found in the "Fama/French 3-Factors"file at Kennth French's data library. Copyright 2016 Kenneth R. French. The HML factor represents returns of a long-short portfolio formed from high book/market stocks minus low book/market stocks, controlling for market capitalization. This is meant to be an educational example and is not intended to represent investment returns generated by an actual portfolio. They do not represent actual trading or an actual account. Results do not reflect transaction costs, other implementation costs and do not reflect advisory fees or their potential impact. Hypothetical results are not indicative of actual future results. Every investment program has the opportunity for loss as well as profit.

[1] Fabrikant, Geraldine, "Investing; A Dwindling Few in Search of Value," *The New York Times*, June 18, 2000.

[2] Price Return. Source: MSCI USA Growth, MSCI USA Value indexes. For illustrative purposes only. Past performance is no guarantee of future results. Investors have the opportunity for loss as well as profits. Copyright MSCI 2016. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI.

Investors tend to pay too much for growth for reasons that vary with changes in economic circumstances. During a bubble, future growth expectations for certain companies often become excessively optimistic. Investors may also feel insurmountable pressure to chase the very stocks that have enjoyed strong run-ups, to align their holdings with those of peers who have enjoyed success. During lackluster economic environments, in contrast, portfolio managers may seek the security of well-known, conventional stocks even if they seem expensive; at such times, companies with a scent of distress may pose unacceptable career risk. In either case, growth may outperform value for prolonged periods.

As most professional investors are already aware, the past several years have marked another episode of significant underperformance for value-oriented strategies, well out of line with value's long-term relative results. Figure 1 places recent value returns in their long-term historical context. Each trace represents a 10-year price path for a long-short value-minus-growth portfolio originating every January since 1927. The most recent, from 2006-2015, is highlighted in blue.

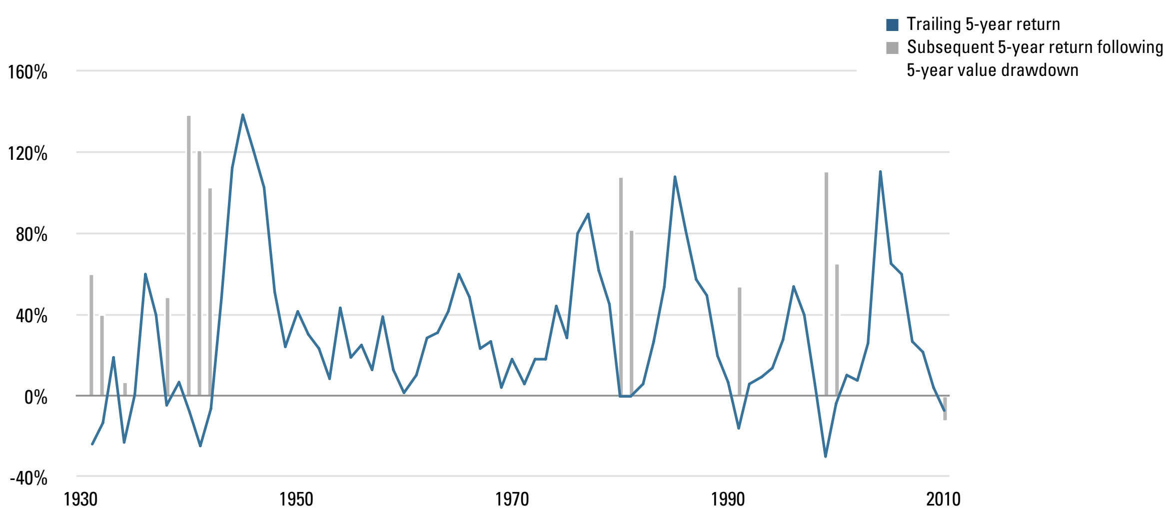
The chart demonstrates just how aberrant value's recent performance has been. By this measure, value lost 19.2% relative to growth in the decade ending 2015. It has performed worse than this only once in the other 79 (overlapping) 10-year runs. Indicative of the durability and consistency of value underpricing, the median outcome represents value outperformance of 58%, and value-minus-growth returns have been positive in 93% of (overlapping) ten-year periods.

Value strategies have also had a strong tendency to recover from periods of underperformance. These reversions are illustrated in Figure 2, which shows that prior episodes of five-year value drawdowns over the past 80 years have often been accompanied by substantial outperformance over the subsequent five years. The current drawdown has thus far been a notable exception.

As we write this, we see evidence that investor sentiment may be turning back towards value. We have seen a rebound in its relative returns, and even popular financial press is suggesting a brightening outlook.[3] This would not be the first time that sentiment has quickly shifted back towards value following a slump. Almost a year to the day after the *Times* published its June 2000 article on dwindling interest in value investing, it ran a story entitled the "Rising Tide for Value," noting a major shift in flows into value-oriented strategies. Over the prior year, value funds had outperformed growth by 30%.[4]

As we look at the performance history of value stocks, investors should be prepared for the potential of a similar significant reversal.

FIGURE 2: 5-YEAR VALUE-MINUS-GROWTH RETURNS FOLLOWING 5-YEAR VALUE-MINUS-GROWTH DRAWDOWNS*



* Calculated from "annual HML" factor returns as found in the "Farma/French 3 Factors" file at Kenneth French's data library. Copyright 2016 Kenneth R. French. This is meant to be an educational example and is not intended to represent investment returns generated by an actual portfolio. They do not represent actual trading or an actual account. Results do not reflect transaction costs, other implementation costs and do not reflect advisory fees or their potential impact. Hypothetical results are not indicative of actual future results. Every investment program has the opportunity for loss as well as profit.

[3] Bray, Andrew, "Move Over, Facebook and Netflix: Value Investing Is Rebounding," *Barron's*, March 12, 2016.

[4] "Investing Diary: A Rising Tide for Value Funds," *The New York Times*, June 24, 2001.

BIOGRAPHY

SETH WEINGRAM, Ph.D.

SENIOR VICE PRESIDENT, STRATEGIST

Seth joined Acadian in 2014 in the role of strategist, aligned closely with Acadian's Marketing & Client Service and Investment teams. Seth brings 17 years of financial industry experience to the firm. Most recently, he was a managing director in Equity Derivatives Trading at UBS, where he ran the electronic options market making desk, led development of quantitative trading tools, and launched Equity Derivatives Strategy. Previously, Seth was a researcher at Barclays Global Investors focusing on options and volatility, and he was a founding member and for several years global head of Deutsche Bank's award-winning Equity Derivatives Strategy Group. Seth holds a Ph.D. in Economics from Stanford University and a B.A. in Economics from the University of Chicago.

GENERAL LEGAL DISCLAIMER

ACADIAN

BOSTON LONDON SINGAPORE TOKYO SYDNEY

ACADIAN-ASSET.COM