MANAGED ASSET PORTFOLIOS

MAP THOUGHT PIECE: Value Versus Growth

MAP'S MARKET PERSPECTIVES | JANUARY 2023

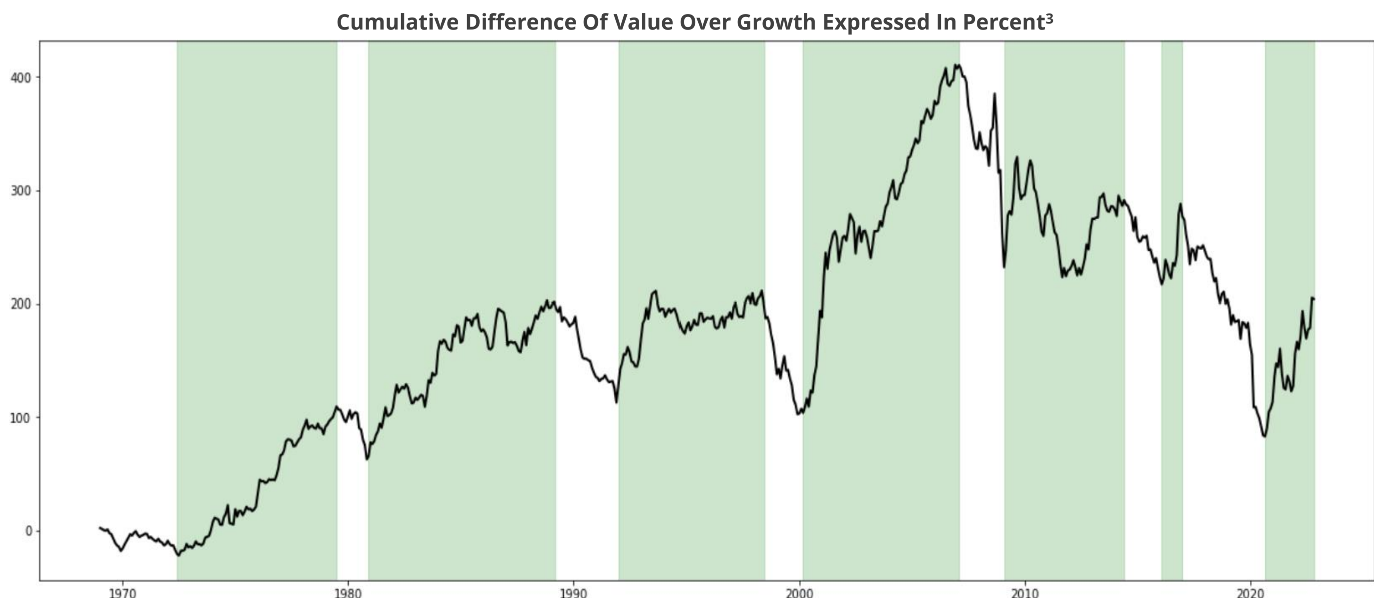
Executive Summary

- Growth has outperformed value in eleven of the past fourteen years, but value has outperformed for the past two years (in 2022, value outperformed growth by 22.69%).[1,2]
- Value and growth cycles are not short-term in nature; they typically last for years.
- When inflation and interest rates are elevated, value has historically outperformed growth.

A Victory Lap For Value

Growth versus value is a near century-long rivalry, but for those with a short-term memory, it has been extremely one-sided. In eleven of the past fourteen years, growth stocks have outperformed value, leading some investors to question the validity of value strategies. But that should come as no surprise considering most of that period coincided with stable inflation, record low interest rates, and the longest economic expansion in U.S. history. However, nothing lasts forever. In fact, the tides finally turned in 2022, as record amounts of fiscal stimulus stemming from the COVID pandemic resulted in demand far exceeding available supply, causing supply chain disruptions and labor market tightness. Given the economy usually operates with a lag, it took some time to materialize, but increased inflation levels finally started flowing through to the economy causing the Federal Reserve (the Fed) to raise interest rates in hopes of curtailing excess demand. The result was a record drawdown in bonds and the popping of a growth stock bubble that had emerged over the prior two years. This left many growth investors with a 2023 outlook that looks uncertain; but given the cyclical nature of investments, value investors may have reason for optimism.

Value vs. Growth[3]



Cumulative Difference Of Value Over Growth Expressed In Percent[3]

Like almost everything in the financial world, as we mentioned previously, value and growth often move in cycles. This cyclicality can (in part) be attributed to the economy, and more specifically, to how inflation and interest rate changes affect the cost of capital. As seen in the graph above, based on analysis from Fama-French[3], value appears to go through extended, multi-year cycles of outperformance as interest rate and inflation regimes tend to take years rather than months to fully play out (the green shaded vertical areas in the above referenced graph depict periods where value outperformed growth).

Because of that, these cycles tend to either start or contain an economic recession as we experienced in 1973-1975, 1980,1981-1982, 1990-1991, 2001, and 2007-2009. The importance of these pro-value cycles cannot be overstated - an investor who bought into the Nasdaq index at its peak of 5,048.60 on March 10, 2000 would have to wait until April of 2015 just to break even. In short, misunderstanding the market environment can impair investors' returns for years to come.

So why do growth stocks outperform during periods of economic stability? Most research points to the cost of capital and the duration of cash flows. In an environment with low inflation and interest rates, investors become more patient, shunning low short-term returns, in favor of investments with the potential for strong cash flow years, if not decades, in the future. As the cycle lengthens you have more and more investors piling into the fastest growing companies leading to premium valuations. For evidence, just look back to the period following the end of the Great Financial Crisis (2009 to 2021). Despite all of the negative headlines, it was a period of relative stability. Minimal geopolitical headwinds, GDP growth hovering around 2%, inflation scarcely above 2.5%, and interest rates largely below 1%. Additionally, during that period, the Next Twelve-Month price-to-earnings (PE) ratio of the Nasdaq 100 increased to more than 30x, its highest level since the dot-com bubble, and the return of the MSCI World Growth Index exceeded its Value counterpart by an annualized average of 5.76% in that same period.[1,2]

However, as that level of outperformance continues year-over-year, investors get a smaller and smaller margin of safety and volatility in the economy or broader markets can cause large drawdowns, erasing a large portion of those returns. Conversely, value stocks are poised to benefit as high rates serve as a constraint on growth, and elevated inflation increases the importance of immediate returns, reducing investor's willingness to pay a premium for future earnings and growth. After a market cycle of neglect, value stocks, with their typically strong cash flows, attractive shareholder returns via share buybacks and dividends, and discounted valuations start to attract inflows. Thus begins the next cycle. This past year was a prime example; as inflation climbed and the Fed raised rates, the MSCI World Value Index outperformed its growth counterpart by 22.69%.[1,2]

Why MAP's Global Equity Composite Over Conventional Value?

Your typical, run-of-the-mill value strategy will passively invest in the "cheapest" 20% of companies based on fundamental ratios like PE and price to sales (PS). However, we believe these fundamental ratios are most useful when combined with qualitative research and top-down thematic filters; after all, investors may find that many of the cheapest 20% of companies are discounted for a reason. MAP's unique and meticulous approach prioritizes risk mitigation coupled with strong returns while taking precautions to avoid the fundamental investor's most common mistake – the so-called 'value trap'. After using fundamental valuations to narrow our scope, we filter out companies based in countries that lack transparency (China, Russia, etc.). Next, we apply our thematic views, whereby our analysts seek out companies that should benefit from the evolving macroeconomic environment. We then seek a catalyst to unlock potential value. Before considering a position for the portfolio, our analysts need a sign that the company is changing trajectories. A catalyst can come in the form of a managerial shift, an activist investor, or the spinoff of a subsidiary, among others. If the stock does have a catalyst, we then conduct in-depth quantitative research and develop an intrinsic valuation. From there, we pick the best 30-50 names to build our portfolio, providing diversity without indexing.

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This selective and active management process has proven to effectively reduce volatility and protect capital during drawdowns, all while generating strong risk-adjusted returns for our clients. Furthermore, it has placed MAP's Global Equity Composite in the top quintile of our Morningstar category, Global Large-Stock Value, for its Sharpe Ratio, Sortino Ratio, and Treynor Ratio over the past 5-, 10-, and 15-year periods. In fact, since the strategy's inception, we have ranked in the top 1% in all of those metrics within our category. We focus on these metrics because they look at the composite's returns relative to the different types of risks investors face including overall volatility (Sharpe Ratio), downside volatility (Sortino Ratio) and beta (Treynor Ratio). And as we describe above, MAP's process is specifically structured to navigate these risks. Tying it all altogether, MAP's Global Equity Composite currently has an Overall Morningstar Rating of Four Stars, a Three-Year Morningstar Rating of Four Stars, a Five-Year Morningstar Rating of Five Stars, and a Ten-Year Morningstar Rating of Four Stars.[5]

Sharpe Ratio	1 Year	% of Peer Group Beaten	3 Years	% of Peer Group Beaten	5 Years	% of Peer Group Beaten	10 Years	% of Peer Group Beaten	15 Years	% of Peer Group Beaten	Com. Incept	% of Peer Group Beaten
MAP Global Equity Composite	-0.62	35	0.17	71	0.26	88	0.54	85	0.41	100	0.51	100
MSCI ACWI GR USD	-0.91	1	0.19	77	0.25	86	0.54	83	0.27	77	0.33	64
MSCI ACWI Value GR USD	-0.42	67	0.16	66	0.16	62	0.44	62	0.21	49	0.29	45
Count	98		91		84		66		39		22	
Sortino Ratio	**1 Year**	**% of Peer Group Beaten**	**3 Years**	**% of Peer Group Beaten**	**5 Years**	**% of Peer Group Beaten**	**10 Years**	**% of Peer Group Beaten**	**15 Years**	**% of Peer Group Beaten**	**Com. Incept**	**% of Peer Group Beaten**
MAP Global Equity Composite	-0.78	41	0.23	68	0.37	87	0.81	86	0.57	100	0.77	100
MSCI ACWI GR USD	-1.12	1	0.27	77	0.36	85	0.80	85	0.38	74	0.46	64
MSCI ACWI Value GR USD	-0.59	69	0.23	66	0.23	63	0.65	62	0.29	46	0.41	45
Count	98		91		84		66		39		22	
Treynor Ratio	**1 Year**	**% of Peer Group Beaten**	**3 Years**	**% of Peer Group Beaten**	**5 Years**	**% of Peer Group Beaten**	**10 Years**	**% of Peer Group Beaten**	**15 Years**	**% of Peer Group Beaten**	**Com. Incept**	**% of Peer Group Beaten**
MAP Global Equity Composite	-13.94	37	3.49	70	4.89	88	8.30	88	7.35	97	9.39	100
MSCI ACWI GR USD	-19.14	3	3.74	73	4.43	83	7.71	80	4.68	69	5.19	50
MSCI ACWI Value GR USD	-9.33	70	3.40	66	3.04	62	6.56	55	3.64	44	4.67	45
Count	98		91		84		66		39		22	

* Peer group is the Morningstar Separate Accounts – US Global Large-Stock Value category. Data as of 12/31/2022.
Source Data: Net, Monthly Return. Calculation Benchmark: MSCI ACWI GR USD

Source: Morningstar Direct®. Statistical performance data has been obtained from sources deemed reliable but are in no way guaranteed by us as to their accuracy. Risk and returns are presented net of fees. Investment advisory fees are described in MAP's Form ADV, Part 2A, Item 5. Past performance is no guarantee of future results. This is not a solicitation by us to buy or sell a particular security. There is no guarantee that any investment will achieve its objectives, generate profits, or avoid losses.

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After more than a decade of growth outperforming value, we believe that the conditions of higher inflation and higher interest rates are poised to define the 2020's as a decade where that trend is reversed. As we all know, mean reversion is a powerful force and it usually does not stop at the average. With that in mind, we believe the MAP Global Equity Composite's strong historical track record of navigating volatile markets and delivering superior risk-adjusted returns makes it an ideal vehicle for investing in this environment.

We work diligently to achieve exceptional long-term risk-adjusted returns. If you have any questions or comments about this piece, or about Managed Asset Portfolios or any of our products, please email us at sales@managedassetportfolios.com or reach out to your investment advisor representative or the firm directly.

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January 2023

Sources:

[1]https://www.msci.com/documents/10199/941f46cd-1562-4b03-8c86-e6f00ddd0e8b

[2]https://www.msci.com/documents/10199/b6f212c4-9897-455a-b323-d5073dd49f7b

[3]https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library/det_form_btm.html. Data is based on portfolios formed on book-to-market ratios by Fama-French. Economists Eugene Fama and Kenneth French define value stocks as those companies with high book-to-market ratios, and growth stocks as those with lower book-to-market ratios. Specifically, the graph shows the cumulative difference of the actual returns of the stocks representing the highest 30% of stocks on a book-to-market basis compared to the actual returns of the stocks representing the lowest 30% of stocks on a book-to-market basis.

[4]https://www.dimensional.com/us-en/insights/are-concerns-about-inflation-inflated

[5]The Global Equity Composite is included in the Global Large Stock Value Morningstar Category™, which contains 86 composites for the overall and 3-year time period, 81 composites for the 5-year time period, and 60 composites for the 10-year time period. © 2023 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

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The Morningstar Rating™ for funds, or "star rating", is calculated for separate accounts with at least a three-year history. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10- year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

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For detailed performance information on the MAP Global Equity Composite please see GIPS Report here.

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