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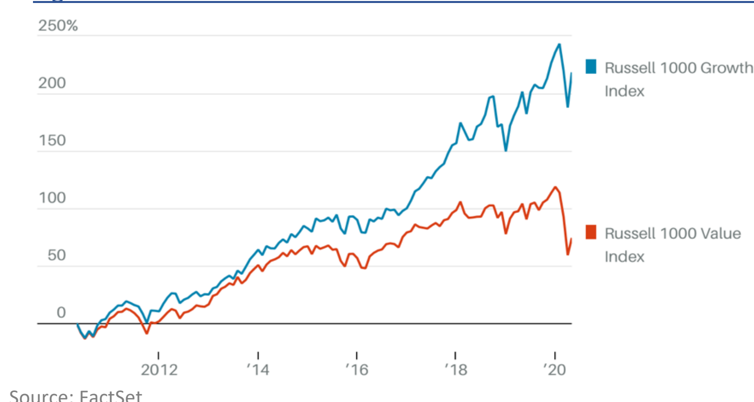
Time for value to shine

We have been hearing so many arguments on whether *value* investing is dead and whether it is going to be different this time. The proponents of this theory argue that we have entered in an environment where *growth* permanently outperforms *value* as it has done for the past 10 years. We believe that the decline in *value* stocks offers a compelling entry point for investors. We lay out below the reasons why we think that now is the time to rebalance portfolios out of *growth* and into *value*. We think that 2021-2022 will be similar to 2001-2002 when the tech bubble burst and *value* investing dramatically outperformed *growth*.

The performance gap between *value* and *growth* is at its widest in at least 25 years. The Russell 1000 Growth Index has more than doubled the Russell 1000 Value Index' return over the past decade (figure 1) and the standard deviation between *growth* and *value* soared from 2 – historical figure – to as much as 10.

Figure 1: iShares Russell 1000 Value vs iShares Russell 1000 Growth



Source: FactSet

The *growth* sector has recently become more momentum driven, accentuated by the Covid-19 pandemic which has accelerated already well-established trends, such as E-commerce, cloud computing, artificial intelligence and digitalization. Looking at tables 1 and 2 showing the performance of some of the top 10 names in both the S&P 500 and NASDAQ, we believe we are now close to a bubble-like valuation where these stocks are borrowing from future performance.

Table 1: Top S&P 500 performers for 2020 (data taken on September 3, 2020)

Company Name	YTD Performance (%)	P/S Ratio
Nvidia	144	25
Advanced Micro Devices	97	13
PayPal Holdings	95	12
Amazon	91	5
Apple	80	8
Netflix	71	11
Salesforce	70	12
Adobe	62	21
Microsoft	48	12
Facebook	47	11

Source: Bloomberg

Table 2: NASDAQ100 performers for 2020 (data taken on September 3, 2020)

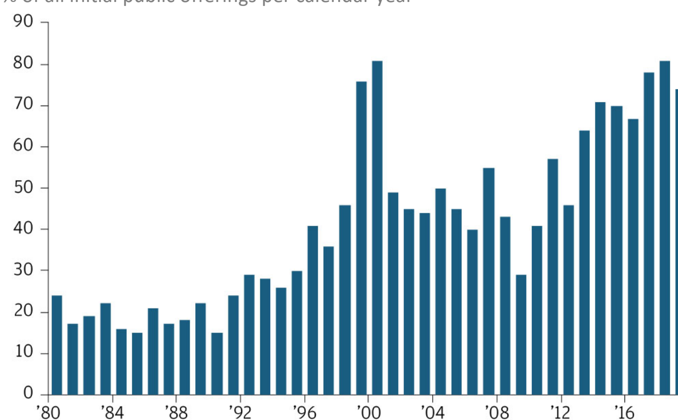
Company Name	YTD Performance (%)	P/S Ratio
Zoom	523	88
Tesla	435	15
Docusign	258	40
Nvidia	144	25
Advanced Micro Devices	97	13
Amazon	91	5
Apple	80	8
Netflix	71	11
Microsoft	48	12
Facebook	47	11

Source: Bloomberg

We hold the view that a relatively small number of *growth* companies are exhibiting classic speculative characteristics associated with late cycle behaviour and potentially establishing a market top in that group. We evidence this as follows:

- Tesla and Apple announced a stock split on August 11 and July 31. Subsequently, their stock rose by 81% and 21% respectively as at the end of August but quickly reversed lower.
- Zoom reported a blowout quarter on August 31, the stock rose by 40% the following day and also sharply reversed downwards.
- A significant portion of the performance of these stocks is driven by the rise of day traders such as Robinhood, which were highly prevalent during the period preceding the market top in 2000.
- The number of companies that recently went public and are not making any money has reached levels not seen since the DotCom bubble, which may serve as a warning that some young *growth* stocks could be particularly vulnerable (Figure 2).

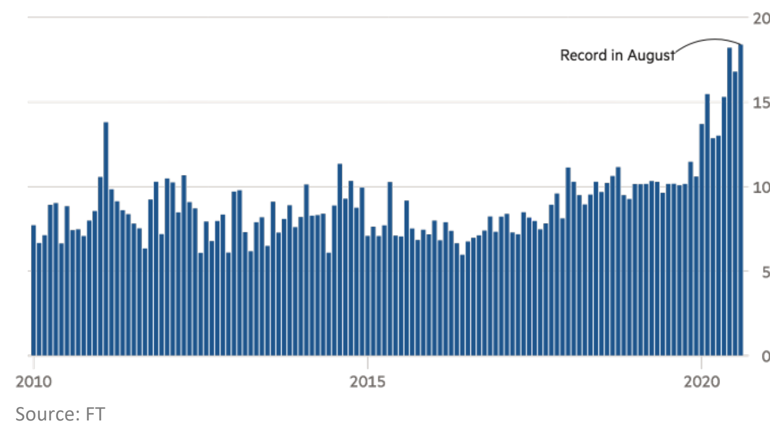
Figure 2: US initial public offerings with negative earnings



Source: Pitchbook, Jay Ritter, University of Florida, J.P. Morgan AM

- The bifurcation of *growth* versus *value* is at an extreme. For instance, Goldman Sachs's market cap is at $75 billion and trades less than book value, whereas Zoom's market cap is $110 billion and trades at 82 times sales.
- The surge in options trading activity on individual tech stocks are back to levels not seen since 2010 – especially by retail investors – suggests a speculative mania as equity options hit new peak in August (figure 3).

Figure 3: Single US equity options volume since 2010



Source: FT

For the reasons outlined above, we believe we are at or near a market top for momentum-driven growth stocks. The market in general will start to focus on *value* and out of *growth*. In early economic cycles like the one we are in now, and as we come out of recession, *value* should start to outperform *growth*.

Value will be back in favour when new "era thinking" disappoints and we are now close to this happening. It wasn't different with the railroads in 1920s, or with the Nifty-Fifty in the 1960s, or with the DotCom bubble in the 2000s. And, we believe, it's not different now, yet it is difficult to pinpoint one single catalyst for this change in market psychology to happen.

Another reason for a potential shift from *growth* to *value* might best be summed up by Herb Stein's line – "that which cannot go on forever, doesn't." *Growth* stocks have outperformed *value* stocks for good reasons, but for many of these companies they have developed an almost cult-like following. Investors are no longer soberly determining an appropriate price to pay for that growth but are instead buying *growth* stocks because they are going up. Higher and higher prices become justified based on the price action. Eventually this sort of mania breaks.

During 2000-2001, Warren Buffet, the dean of *value* investors, was written off as having missed the tech rally and not being relevant anymore as an investor. When the NASDAQ peaked in March 2000 and subsequently halved in a period of 1 year, *value* dramatically outperformed *growth* for next 2 years. It so happens that Buffet recently made a huge bet on Japan – a *value* market – where he bought stakes in five of the largest trading companies screening cheap on all valuation metrics. We think his timing could well prove to be excellent this time.

For the reasons outlined above, we think we are at or near an inflection point where *value* starts to outperform *growth* and that now is the time to make such a shift by at least underweighting *growth* and overweighting *value*.

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