

# The Case for Continued Value Outperformance

January 2023

## Introduction

After years of underperformance, value stocks outperformed growth stocks in 2022. Many of the conditions that existed during 2022 persist and we believe value may be positioned to outperform growth again in 2023.

## Recent Value and Growth Performance of the Indices

In 2022, value outperformed growth for the first time in five years and for just the fourth time since 2009 as shown in the chart below.

Annual Returns				
Year	Russell 1000 Growth Index	Russell 1000 Index	Russell 1000 Value Index	Value - Growth Return Spread
2009	37.2	28.4	19.7	-17.5
2010	16.7	16.1	15.5	-1.2
2011	2.6	1.5	0.4	-2.3
2012	15.3	16.4	17.5	2.3
2013	33.5	33.1	32.5	-0.9
2014	13.1	13.2	13.5	0.4
2015	5.7	0.9	-3.8	-9.5
2016	7.1	12.1	17.3	10.3
2017	30.2	21.7	13.7	-16.6
2018	-1.5	-4.8	-8.3	-6.8
2019	36.4	31.4	26.5	-9.9
2020	38.5	21.0	2.8	-35.7
2021	27.6	26.5	25.2	-2.4
2022	-29.1	-19.1	-7.5	21.6

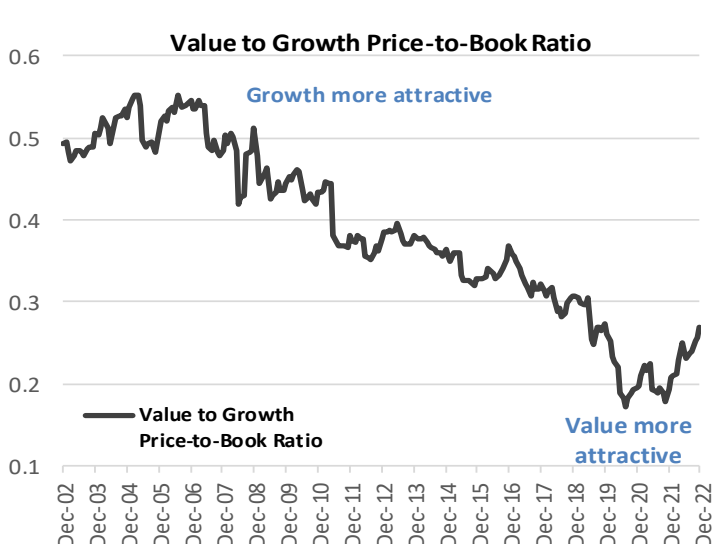
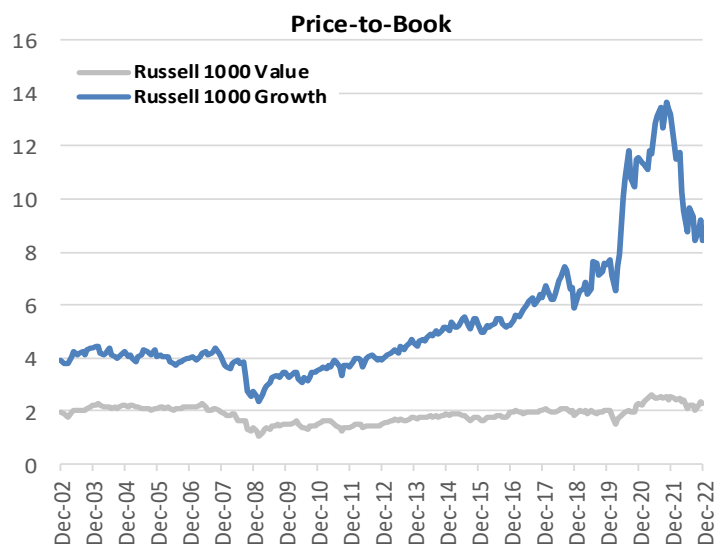
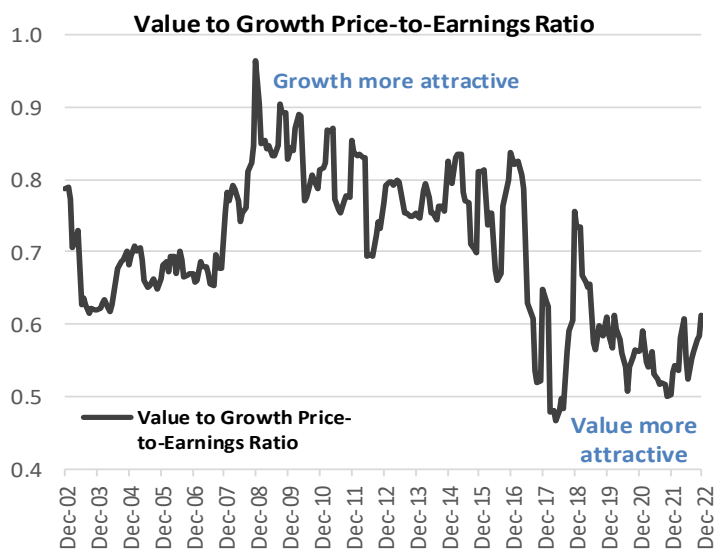
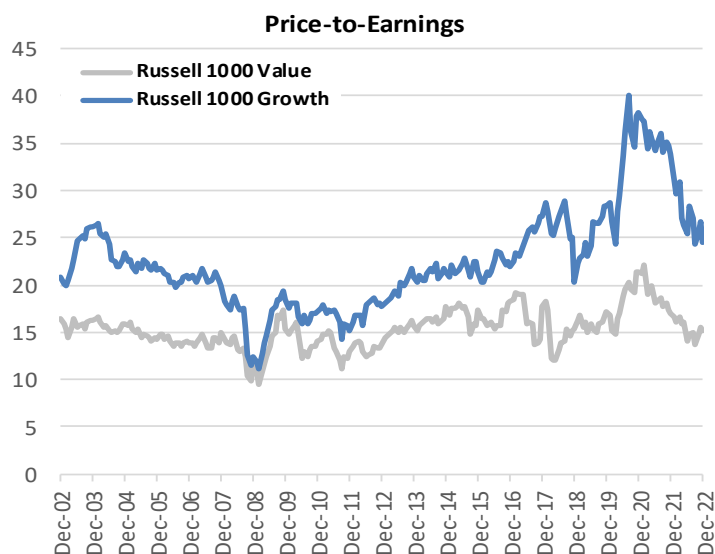
Source: Longfellow Investment Management, Russell, Factset

We believe the current environment continues to favor value outperformance. Value stocks still appear inexpensive relative to growth stocks and the Russell 1000 Value Index exhibits lower benchmark concentration risk than the Russell 1000 Growth Index.

## Value and Growth Valuations

At the beginning of 2022, after a multi-year period of outperformance, the Russell 1000 Growth Index appeared expensive relative to history, trading at a price-to-earnings ratio of about 34 (vs. a 20-year average of 22) and a price-to-book ratio of 13 (compared to a 20-year-average of 5). On the other hand, the Russell 1000 Value Index appeared to be more attractively valued, especially when compared to the Russell 1000 Growth Index.

As of the end of 2022, despite underperformance during the prior 12 months, the Russell 1000 Growth remains expensive on both price-to-earnings and price-to-book. Meanwhile, relative to the Russell 1000 Growth, the Russell 1000 Value looks to be very attractively valued. On the following page, the charts on the left depict the price-to-earnings and price-to-book ratios of the Russell 1000 Growth and Russell 1000 Value. The charts on the right depict the value-to-growth ratio of these metrics. For the charts on the left, lower levels signify that the Russell 1000 Value looks cheaper, and more attractive, relative to the Russell 1000 Growth.

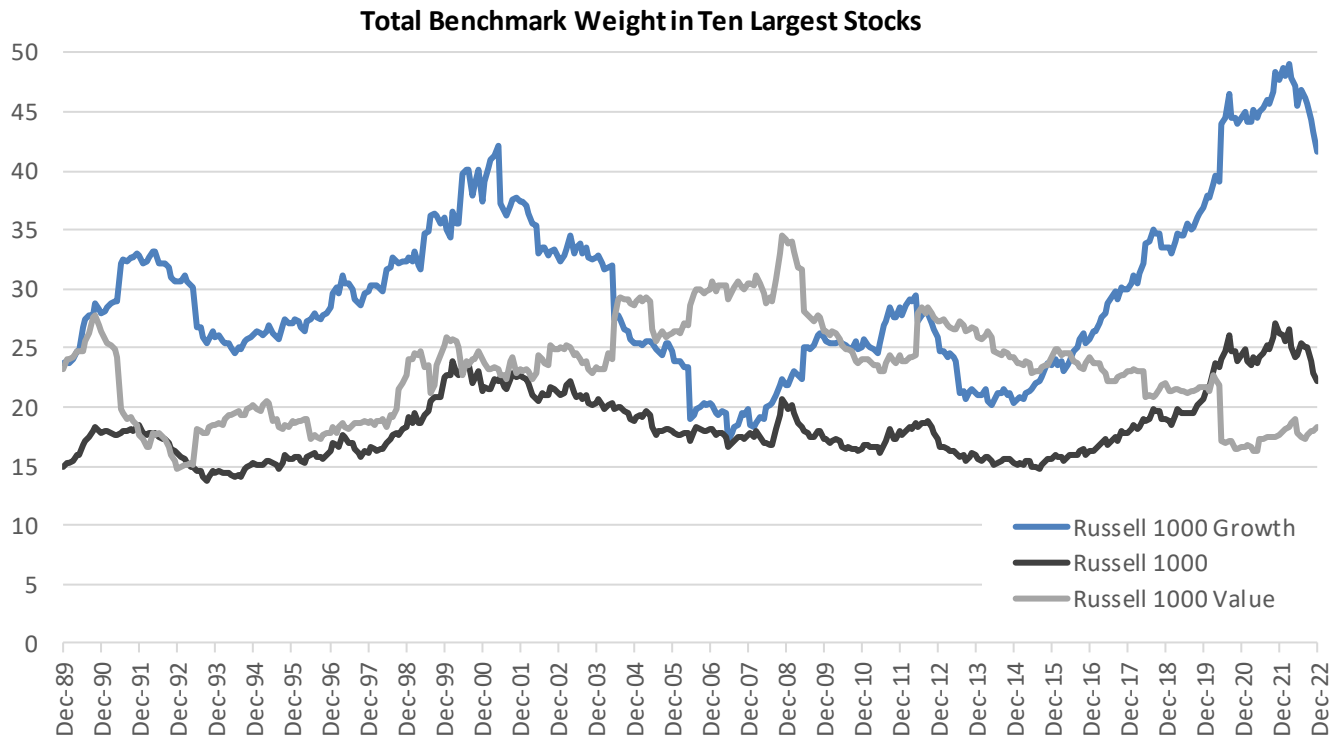


Source: Longfellow Investment Management, Factset, Russell. The charts on the left plot the price-to-earnings (PE) and price-to-book (PB) ratios each respective index for each monthly time period referenced above (December 2002 – December 2022). The charts on the right depict the ratios of Russell 1000 Value PE / Russell 1000 Growth PE and Russell 1000 Value PB / Russell 1000 Growth PB.

### Benchmark Concentration Risk

Although benchmarks can consist of hundreds of names, the largest stocks can at times become very large compared to the other stocks in the benchmark. When this happens, risk increases as diversification decreases and the performance of the benchmark can increasingly be influenced by just a handful of its constituents. Analyzing the combined weight of the top 10 stocks in the Russell 1000 benchmarks, we see that the concentration in both the Russell 1000 Growth and Russell 1000 had become extreme at the beginning of 2022. The combined weight of the top 10 stocks in the Russell 1000 Growth was nearly 49% while in the Russell 1000 it was about 26% -- all-time-high concentration levels dating back to 1989, surpassing the prior peak seen at the end of the Technology/Telecomm bubble. The Russell 1000 Value benchmark, on the other hand, did not exhibit the same extreme concentration levels. In fact, the Russell 1000 Value concentration level was low relative to history. With the underperformance of some mega-cap growth stocks in 2022, the growth concentration numbers have decreased somewhat but remain very high relative to history. The value concentration level, on the other hand, remains near all-time lows.

We believe these relative concentrations could present a tailwind for value stock outperformance. After the prior peak at the end of the Technology/Telecomm bubble in 2000, the Russell 1000 Growth concentration levels steadily fell until bottoming out at 17.1% in June 2007. As the growth concentration levels fell, the Russell 1000 Value outperformed the Russell 1000 Growth every calendar year from 2000-2006. The chart below depicts the total weight in the 10 largest stocks in of each respective index by the combined percentage of their market capitalization for each month-end from December 1989 – December 2022.



Source: Longfellow Investment Management, Factset, Russell. The chart plots the top 10 stocks of each respective index by the combined percentage of their market capitalization for each time period referenced above (December 1989 – December 2022).

### Conclusion

After years of underperformance relative to growth, value outperformed growth in 2022. We believe the valuation and benchmark concentration environment may continue to favor value stocks outperformance into 2023. However, past performance is not an indication of future results. Investment involves the possible loss of principal.

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Refer to the next page for additional Important Disclosures.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe, whereas the Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe.

## Important Disclosures

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