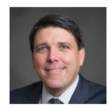
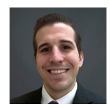
Did you miss the rotation from growth to value?

Adding cyclicality through value stocks could help prepare portfolios for the post-pandemic economy.

February 2021



Terry Davis
Portfolio Construction Specialist



John Gray, CFA
Portfolio Construction Analyst

KEY INSIGHTS

- With markets optimistic about the prospects for COVID-19 vaccine development and distribution, now may be a good time to consider adding cyclicality through value stocks.
- Growth/value performance cycles have tended to last for several years, but style regime changes can be abrupt when they occur, particularly at extremes—and the current environment appears extreme by several key measures.
- Over the past three years, financial professionals significantly increased their allocations to growth stocks at the expense of value.
- Our research suggests that diversifying by investment style historically has improved returns, efficiency, and consistency versus investing just in U.S. large-cap blend.

Are you preparing for a post-COVID-19 economy?

Markets entered 2021 amid optimism as public health officials gained access to multiple vaccines to fight the global coronavirus pandemic. We expect vaccine developments to be game-changers over the coming months as manufacturing accelerates, distribution and administration issues are resolved, and mass inoculations hopefully lead to the desired herd immunity.

Against this backdrop, now may be a good time to think about positioning investment portfolios for a post-pandemic economy. The T. Rowe Price Portfolio Construction team has spoken with clients about ways to add cyclicality to portfolios in order to take advantage of the post-COVID-19 economy, and our research suggests that value style equities could play a key role.

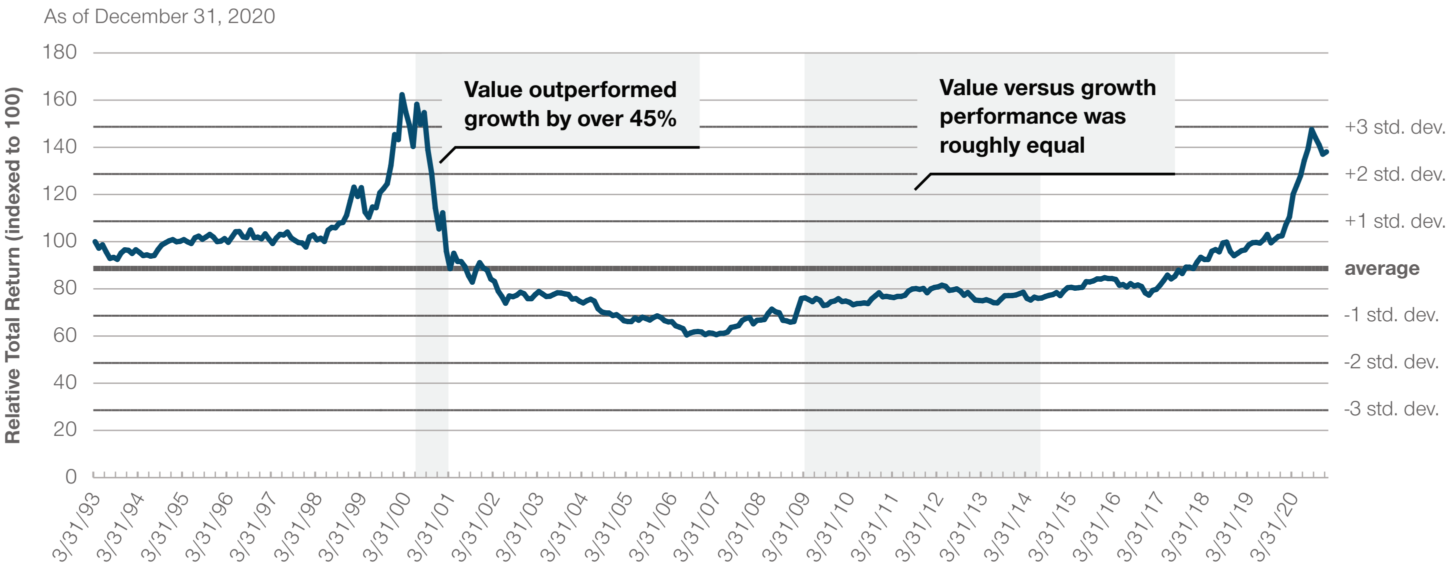
The stakes are high as style reversals can be sharp and swift

Looking at Figure 1, the relative returns for large-cap U.S. growth stocks versus their value counterparts since April 1993 reveal some interesting observations about growth/value performance cycles.

- **Performance cycles tended to persist for several years.** T. Rowe Price's U.S. equity team looked at growth and value equity returns from June 1926 through December 2020. On average, value performance cycles lasted approximately 64 months, while growth cycles lasted about 45 months. At 173 months through December 2020, the most recent growth cycle is the longest on record.

Growth/value performance cycles have tended to vary in duration and intensity.

(Fig. 1) Total Return: Russell 1000 Growth Index versus Russell 1000 Value Index, April 1993 through December 2020.



Past performance is not a reliable indicator of future performance.

Index performance is for illustrative purposes only and is not indicative of any specific investment. investors cannot invest directly in an index.

Sources: T. Rowe Price analysis using data from FactSet Research Systems, Inc; Russell Investment Group. Please see Additional Disclosures for more information.

- **Performance differentials have been insignificant at times...** From April 2009 through July 2014, the performance of growth and value stocks was roughly equal despite a challenging economic backdrop, which included the European sovereign debt crisis, U.S. federal debt downgrade, and extreme volatility in oil prices.

- **...but style regime changes can be abrupt, especially at extremes.** In the nine-month period from July 2000 through March 2001, value stocks outperformed growth by more than 45%.

- **The current backdrop appears extreme.** Late in 2020, growth outperformance reached extreme levels and was nearing a three standard deviation event. Despite the fourth-quarter rally in value stocks, relative returns for growth stocks still exceeded two standard deviations.

Did the value rotation already pass you by?

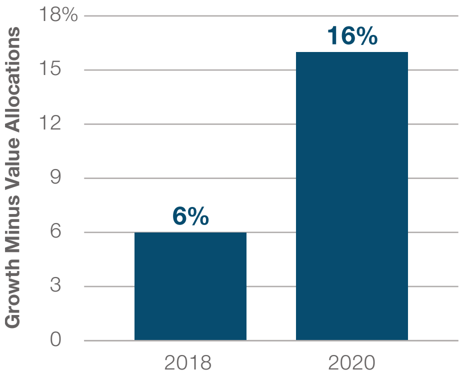
The big question: Have you missed the rotation to value? In the wake of value's outperformance in the fourth quarter of 2020, it's one of the most common questions we hear in our daily interactions with financial professionals.

In our opinion, the short answer is no. First, relative valuations still look stretched toward growth despite the recent rally in value stocks. Second, the average value cycle persisted for about 64 months, and we're now only three months into a potential rotation. Third, our expectations for more robust economic growth in the latter half of 2021 should favor value over growth.

Currently, our Asset Allocation Committee favors U.S. value stocks over growth in multi-asset portfolios. Growth stocks appear vulnerable to extended valuations and narrow market leadership. More cyclical value stocks could benefit from pent-up demand, economic improvement, higher interest rates, and fiscal stimulus.

Financial professionals significantly increased growth allocations at the expense of value allocations.

(Fig. 2) Growth minus value allocations, 2018 versus 2020



Sources: T. Rowe Price Client Investment Platform (CIP); Morningstar Direct.

Based on moderate-risk model allocations and underlying fund exposures as of 12/31/2020. The sample includes 804 total models.

Relative valuations still favor value stocks even after their fourth-quarter rally.

Are your portfolios positioned for a value rotation?

Proprietary data used by our Portfolio Construction Solutions team reveal that many model portfolios used by financial professionals have significantly increased their allocations to growth stocks at the expense of value allocations. As shown in Figure 2, growth allocations were 16 percentage points above value at the end of 2020 versus a six-point tilt toward growth just three years ago. As the outlook for value brightens in 2021, a reassessment of investment style allocations may be in order. Growth overweights persist in many client portfolios, and we believe financial professionals should consider shifting toward a more neutral growth/value stance.

Using Morningstar investment category averages, Figure 3 shows the potential benefits of growth/value style diversification within a U.S. large-cap equity allocation. The analysis compares long-term performance characteristics of three Morningstar U.S. large-cap category averages with two hypothetical blended allocations containing these categories. The analysis shows that relative to a standalone allocation to U.S. large-cap blend, an equally-weighted blend between all three styles exhibited better returns, more efficient performance, and improved long-term return consistency.

Use our expertise to improve your solutions

Whether you want to maximize value opportunities or minimize downside risks, our experienced investment professionals are ready to help. Built on the same foundation that supports our world-class Multi-Asset Division, our integrated suite of Portfolio Construction Solutions is designed to enhance investment outcomes and help position your practice for success. Contact your T. Rowe Price representative to learn more.

Style diversification has improved portfolio performance, efficiency, and consistency.

(Fig. 3) Impact of portfolio diversification across Morningstar style categories.

25-Year Performance

December 31, 1995, through December 31, 2020

	Morningstar U.S. Large Blend	Morningstar U.S. Large Growth	Morningstar U.S. Large Value	Large Blend (50%) Large Growth (50%)	Large Blend (33%) Large Growth (33%) Large Value (33%)
Risk/Reward					
Annualized Return	8.02	9.13	7.47	8.60	8.27
Standard Deviation	15.04	17.06	14.82	15.91	15.27
Sharpe Ratio	0.44	0.47	0.41	0.46	0.45
Rolling Success Rates					
3-Year		65%	39%	65%	71%
5-Year		63%	43%	66%	75%
10-Year		50%	50%	50%	89%

Past performance is not a reliable indicator of future performance.

Source: Morningstar Direct. Calculation benchmark: Morningstar U.S. Large Blend category average. Rolling success rates calculated using 1-month moving windows. Hypothetical blended allocations rebalanced monthly. The hypothetical Large Blend (50%)/Large Growth (50%) portfolio illustrates equal allocations to U.S. Large Blend and U.S. Large Growth Morningstar categories within an allocation to U.S. large-cap stocks. The hypothetical Large Blend (33%)/Large Growth (33%)/Large Value (33%) illustrates allocations to U.S. Large Blend, U.S. Large Growth, and U.S. Large Value Morningstar categories within an allocation to U.S. large-cap stocks.

The performance shown is hypothetical for illustrative purposes only and does not represent the performance of a specific investment product or portfolio. Performance does not reflect the expenses associated with the management of an actual portfolio and is not a guarantee of future results. Illustration assumes reinvestment of income and no transaction costs or taxes. Morningstar category average performance is calculated net of fees and the underlying allocations are rebalanced monthly. Dividends and capital gains distributions are reinvested monthly. Actual results may differ significantly from those shown above.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T. Rowe Price®

Additional Disclosures

Important Information

Sharpe Ratio: An investment measurement that is used to calculate the average return beyond the risk-free rate of volatility per unit.

Standard Deviation: Indicates the volatility of a portfolio's total returns as measured against its mean performance.

Risks: Investing involves risk, including loss of principal. Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.

Value investing is subject to the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced. Value and growth investing styles may fall out of favor, which may result in periods of underperformance.

This material is provided for general and educational purposes only and not intended to provide legal, tax, or investment advice. This material does not provide recommendations concerning investments, investment strategies, or account types; it is not individualized to the needs of any specific investor and not intended to suggest any particular investment action is appropriate for you, nor is it intended to serve as the primary basis for investment decision-making. T. Rowe Price group of companies, including T. Rowe Price Associates, Inc., and/or its affiliates, receive revenue from T. Rowe Price investment products and services.

The views contained herein are those of authors as of February 2021 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

Past performance cannot guarantee future results. All charts and tables are shown for illustrative purposes only.

Portfolio construction services discussed are available only to financial professionals and not to the retail public.

T. Rowe Price Investment Services, Inc., Distributor. Investment advisory services are provided by T. Rowe Price Associates, Inc. T. Rowe Price Associates, Inc. and T. Rowe Price Investment Services, Inc. are affiliated companies.