



# Why Value Stocks Are Becoming More Competitive Again

The investment environment has undergone a decisive shift.

February 2023

After a decade of dominance by growth stocks, value stocks came back with a vengeance last year: The MSCI World Value Index outperformed its growth counterpart by more than 20 percentage points. This does not necessarily mean that value investing is set to dominate growth for the next decade, but it supports my view that the headwinds facing value stocks are easing and that, at the very least, value is set to become more competitive than at any time since the global financial crisis (GFC).

Why did growth stocks dominate for so long? Partly because, following the GFC, there was a long period of low interest rates, which have tended to favor growth stocks that promise stronger cash flows in the distant future. Bond math suggests that lower interest rates cause longer-dated cash flows to have higher present values. Value stocks are not helped as much by lower interest rates because value firms are typically expected to generate profits over a shorter time horizon.

While interest rates have been a factor, we believe the main reason for the dominance of growth stocks is that disruptive technology, including online shopping and digital marketing, really delivered for investors. The market was



**John Linehan**

Chief Investment Officer, U.S. Equities

slow to understand the potential of many of these stocks, which then substantially exceeded expectations. As the potential of some of the new technology became clear, investors piled in, fueling a boom period for growth stocks.

I believe the period ahead will be different. For one thing, a return to very low interest rates is very unlikely in the foreseeable future. While inflation will likely come down from current levels, the onshoring and “near shoring” of supply chains means we may be heading into a new epoch in which inflation remains elevated for an extended period as deglobalization makes it more difficult for companies to reduce labor and raw material costs. If that happens, rates, too, will remain high compared with recent history. In higher rate environments, current earnings tend to become more valuable and future earnings less valuable, which favors value stocks.

“...a return to very low interest rates is very unlikely in the foreseeable future.”

**Past performance is not a reliable indicator of future performance.**

## The Investment Environment Is Changing

(Fig. 1) Valuations will matter more in the period ahead

What's Changing	Possible Features of the Next Decade
<p><b>Interest Rates and Inflation Likely to Be Higher</b></p> <ul style="list-style-type: none"><li>Increased nationalism and “near shoring”/onshoring of supply chains could lead to a different inflation epoch, putting upward pressure on interest rates.</li></ul> <p><b>Innovation Better Understood</b></p> <ul style="list-style-type: none"><li>Incumbents in key industries are responding, creating competition for disruptors (e.g., direct-to-consumer media, battery electric vehicles, retail).</li></ul> <p><b>Value Has Done Well in Wake of Speculative Excess</b></p> <ul style="list-style-type: none"><li>Value outperformed after the “Nifty-Fifty” and “dot-com” bubbles as high embedded expectations did not match actual fundamentals.</li></ul>	<p><b>Equity Has to Compete With Other Asset Classes</b></p> <ul style="list-style-type: none"><li>“There is no alternative” (TINA) concedes to “there are numerous alternatives” (TANA).</li></ul> <p><b>Value Investing Is More Competitive</b></p> <ul style="list-style-type: none"><li>Valuation matters more, as investors demand cash flow over revenue growth.</li><li>Higher inflation and interest rates create broader earnings growth in equity markets.</li><li>Disruption continues but is better understood.</li></ul> <p><b>Dividends Matter More</b></p> <ul style="list-style-type: none"><li>Down or sideways market makes dividend yield a bigger part of total return.</li><li>Higher-yielding dividend stocks are currently unusually cheap.</li></ul>

As of January 31, 2023.  
Source: T. Rowe Price.

“...higher interest rates and the maturing of the recent period of disruptive technology may establish a better environment for value stocks.”

In addition, while the era of technological disruption is not over, we believe we have entered a more mature phase in this process. We are circumspect about our ability to predict the future, but we think it likely that in 10 years' time people will still be streaming videos, shopping on the internet, and driving more electric vehicles. However, these industries are likely to become more competitive. Early innovators may not be the best long-term investments from here: Netflix and Tesla, for example, will both face stiff competition as other companies innovate and catch up. Over the next 10 years, the most attractive investments may be in older incumbents that have been hit hard by disruption but can also leverage the new technology and effectively compete in the new categories. For example, if Volkswagen, which currently has an extremely low valuation, ultimately produces electric vehicles that are competitive with the high standard set by Tesla, expectations for both companies may be wrong.

In the past, value has performed well following periods of speculative excess (for example the “Nifty-Fifty” and “dot-com” eras) as high embedded expectations turned out not to match actual fundamentals. If the current period of speculative excess comes to an end as the era of disruptive technology matures, value companies may benefit once again.

Combined, I believe that an extended period of higher interest rates and the maturing of the recent period of disruptive technology may establish a better environment for value stocks. This is not to suggest that value will dominate the next 10 years in the way that growth has dominated the past 10, but it does mean that value investing is likely to play a more important role in investor portfolios as higher rates create broader earnings growth and investors focus more on cash flows.

The specific securities identified and described are for informational purposes only and do not represent recommendations.

## Value Is a Key Component of Portfolio Construction

(Fig. 2) Portfolios need both growth and value stocks

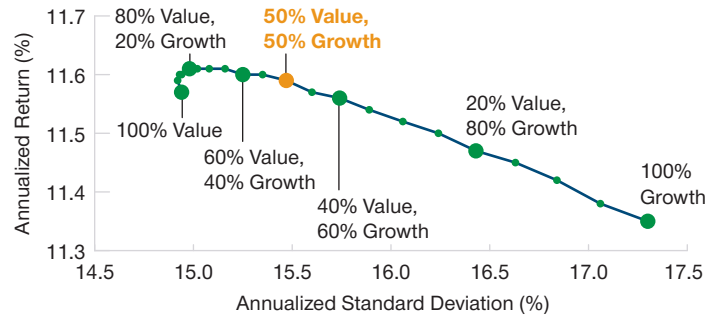
	Total Return (Annualized)	Standard Deviation (Annualized)	Sharpe Ratio
Russell 1000 Value	11.58%	14.94%	0.49
Russell 1000 Growth	11.35%	17.30%	0.41
	↓	↓	↓
<b>50/50 Portfolio*</b>	<b>11.59%</b>	<b>15.47%</b>	<b>0.48</b>

From January 1, 1979 to December 31, 2022.

**Past performance is not a reliable indicator of future performance.** Index performance is for illustrative purposes only, is not indicative of any specific investment, and does not reflect fees and expenses associated with an investment. Investors cannot invest directly in an index.

\*50/50 Portfolio represents a mix of 50% within both the Russell Large Value and Russell Large Growth representative indices.

Source: T. Rowe Price.



Although expectations and valuations for growth stocks have fallen to a degree, they remain elevated compared with value stocks. With higher expectations, the downside risk associated with disappointment in the trajectory of company fundamentals is considerable; conversely, there is a relatively lower expectation of value stocks.

I will explore these ideas in more depth in further blogs over the coming months. For now, it is worth reiterating my view that the current investment climate for value stocks is as favorable now as at any time since the GFC.

## INVEST WITH CONFIDENCE<sup>SM</sup>

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

# T.RowePrice<sup>®</sup>

---

### Important Information

**This material is being furnished for general informational and/or marketing purposes only.** The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. 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. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

**DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.**

---

## Important Information (cont.)

**Australia**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

**Brunei**—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

**Canada**—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

**EEA**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**Hong Kong**—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

**Indonesia**—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

**Korea**—This material is intended only to Qualified Professional Investors. Not for further distribution.

**Mainland China**—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

**Malaysia**—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

**New Zealand**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

**Philippines**—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

**Singapore**—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

**South Africa**—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), 60 Queen Victoria Street, London, EC4N 4TZ, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: [www.faisombud.co.za](http://www.faisombud.co.za), Email: [info@faisombud.co.za](mailto:info@faisombud.co.za)

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

**Taiwan**—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

**Thailand**—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**USA**—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.