MULTI-ASSET INSIGHTS

VALUE THE SMALLER THINGS

MAY 2020

Our multi-asset and equity teams recently conducted analysis to better understand U.S. small- and mid-cap value performance following periods of broad U.S. equity market selloffs. They found that:

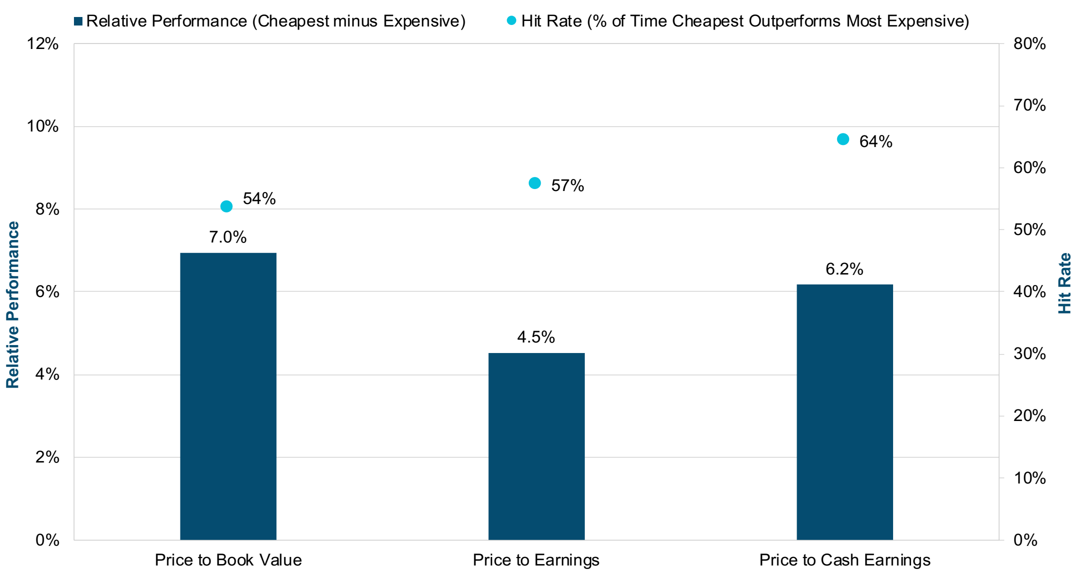
- Small- and mid-cap value stocks—across a range of measures—tended to outperform their expensive peers in the 12 months following the market drawdown. (Exhibit 1 below)
- The relative outperformance of small- and mid-cap value versus growth stocks can occur rapidly. (Exhibit 2 below)

Given that evidence, the team believes that maintaining small- and mid-cap value stock exposure through investment cycles is important but may be especially important following large market drawdowns. This may be best achieved through a disciplined rebalancing process to ensure portfolio exposures are intentional and aligned with allocation targets.

The below chart shows the forward 12 month small- and mid-cap value performance and hit rate across three common value measures following a period when the broad U.S. stock market has been down 20%. As shown, cheap stocks have outperformed (1) consistently and (2) by a sizable margin during the majority of periods.

SMALL- AND MID-CAP VALUE STOCKS HAVE TYPICALLY OUTPERFORMED EXPENSIVE STOCKS DURING THE 12 MONTHS FOLLOWING A MARKET DECLINE OF 20% OR MORE

12-Month Forward Value Returns by Various Measures and Hit Rate



Past performance is not a reliable indicator of future performance.
Source: Fama-French data sourced from the Ken French Data Library. http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html
Analysis performed by T. Rowe Price.
The Fama/French benchmark portfolios are rebalanced quarterly using two independent sorts on size (market equity, ME) and book-to-market (the ratio of book equity to market equity "BE/ME". The size breakpoint (which determines the buy range for the Small and Big portfolios) is the median NYSE market equity. The BE/ME breakpoints (which determine the buy range for the Growth, Neutral, and Value portfolios) are the 30th and 70th NYSE percentiles.

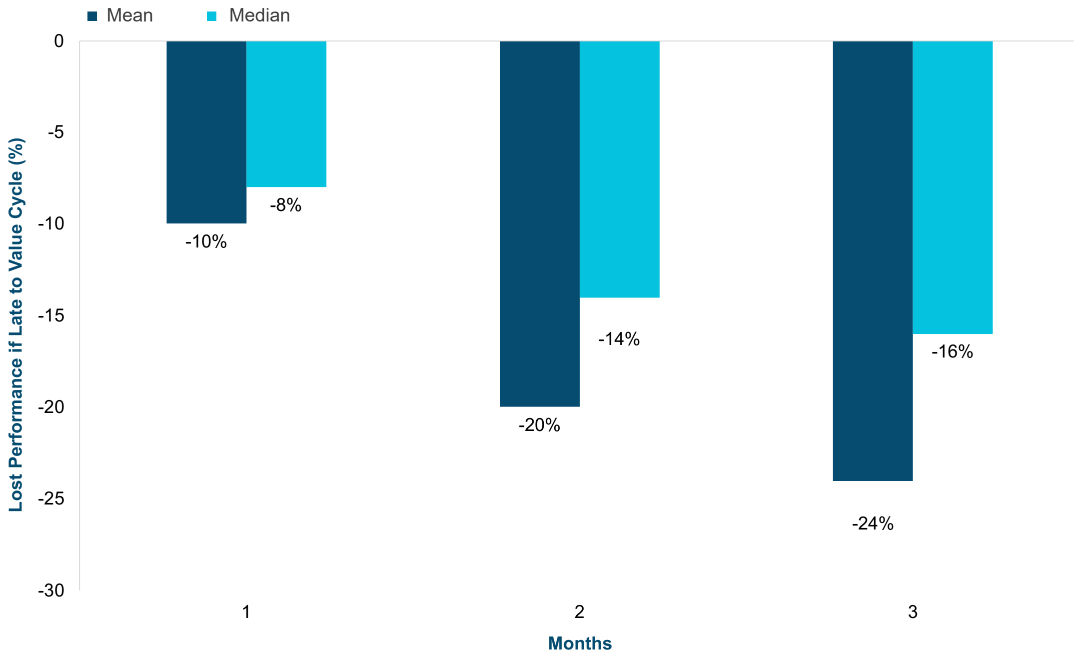
Another interesting dynamic observed is that the relative outperformance of small- and mid-cap value versus growth stocks can occur very rapidly. The chart below shows the percent of small- and mid-cap value's relative outperformance of growth lost if an investor is just 1, 2, or 3 months late to investing in such securities. For example, an investor that mis-timed the small- and mid-cap growth vs. value rotation by 3 months would have historically missed up to 24% of value's relative outperformance, on average.

Our finding that small- and mid-cap value stocks historically have tended to outperform their more expensive peers following broad market declines, combined with the fact that this relative performance shift potentially can occur very abruptly, reinforces the importance of maintaining value exposure through all investment cycles, in our view.

PERCENTAGE OF SMALL- AND MID-CAP VALUE'S RELATIVE OUTPERFORMANCE LOST BY BEING 1 TO 3 MONTHS LATE

Periods during which small value outperformed small growth by at least 20%, for at least three months

31 July 1929 through 31 March 2020



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