



ASSET ALLOCATION INSIGHTS

Sticking With Value

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KEY INSIGHTS

- The value rally has recently fizzled, and growth stocks have regained ground, narrowing the performance gap considerably.
- Despite strong fundamentals, growth stock valuations are extreme. The Asset Allocation Committee favors value stocks as potential catalysts could be supportive.

From November 2020 to early May 2021, U.S. value stocks generated strong absolute and relative performance versus U.S. growth stocks, a trend also seen in global equity markets. However, the value rally has recently fizzled, and growth stocks have regained ground, narrowing the performance gap considerably (see Figure 1).

While somewhat unexpected, the resurgence in growth stocks is supported by their attractive fundamentals—very strong revenue growth amid increasing margins over the past 10 years—versus value stocks. Going forward, investors should weigh whether or

not these trends that have boosted growth stocks over the past decade will continue to prevail.

Notably, the pandemic strengthened some technology trends, including online retail, social media, video streaming, and cloud computing, and new trends—such as the push toward renewable energy—could provide additional tailwinds. However, with these high expectations, growth stock valuations have been driven to extreme levels relative to value stocks (see Figure 2), leaving little room for error should outcomes disappoint.

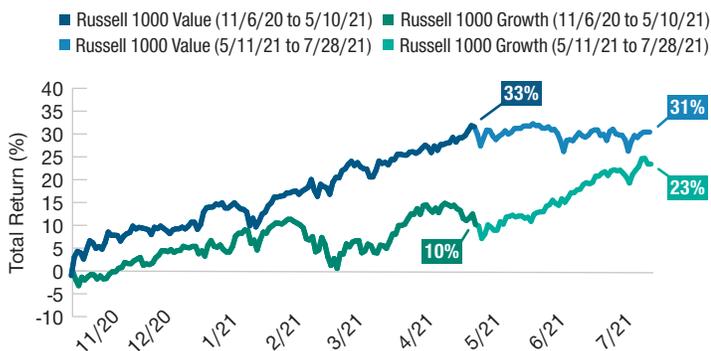
In our view, the significant valuation difference between growth and value stocks may not be sustainable, and potential catalysts, including higher inflation and rising interest rates, could narrow the gap in the medium term. In the U.S., increased government spending, higher taxes on foreign earnings, and tighter regulation of technology companies could also be supportive.

We believe that these conditions, should they materialize, would likely favor value stocks and be a headwind for growth stocks. As a result, the Asset Allocation Committee maintained our tilt toward value stocks.

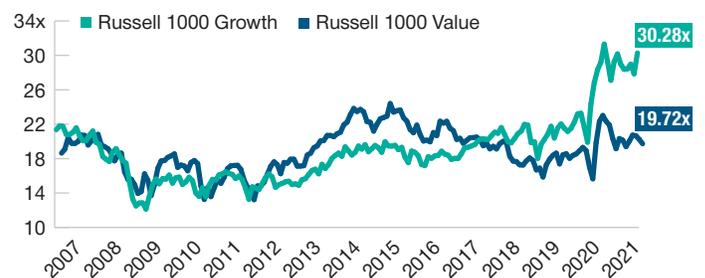
A Short-Lived Value Rally

Stronger fundamentals for growth stocks, but valuations are extreme

(Fig. 1) Value vs. Growth (Total Return, 11/6/20 to 7/28/21)



(Fig. 2) Forward Price/Free Cash Flow Ratios (Month-end January 2007 to June 2021)



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