

The Global Value-Stock Rally Turns 1: Can it Continue?

NOVEMBER 2021

Snapshot

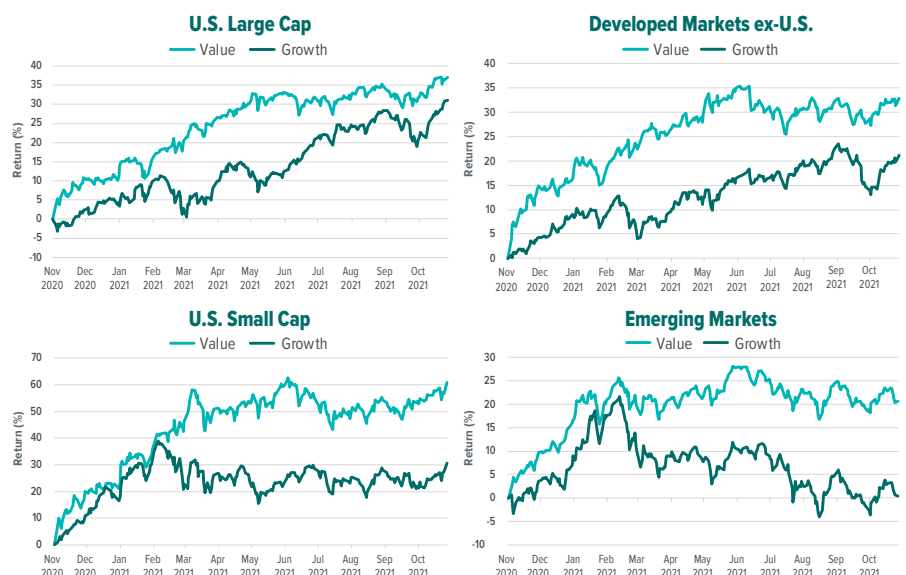
- Value stocks have retained their lead over growth stocks for the past year across U.S. and international markets alike.
- Growth stocks rebounded from the spring to the summer in U.S. large caps—and, to a lesser extent, in small cap and international developed markets—but essentially ran out of fuel at the end of the summer.
- Value stocks have actually become less expensive in 2021 on a forward price-to-earnings basis as their earnings expectations improved. This has driven the valuation spread between value and growth back to the historic extreme that existed prior to the rotation to value that began on November 9.

It's been 12 months since "Pfizer Monday" (November 9, 2020, when Pfizer announced the development of the first successful COVID-19 vaccine). This date became the inflection point of value-oriented stocks' return to favor versus growth amid a broad recovery rally.

How has the value rotation played out around the world?

Unevenly, to say the least. Exhibit 1 shows clear divides between U.S. and international stocks, as well as between more efficient market segments (like U.S. large caps and developed markets, which have more trading activity, higher liquidity, and better analyst coverage of companies and trends) versus less efficient segments (like U.S. small caps and emerging markets).

Exhibit 1: Tight Race in U.S. Large Caps, Value's the Clear Winner Everywhere Else



Performance measured in total return terms from November 6, 2020 through November 1, 2021. Sources: Bloomberg, SEI. See "Corresponding Indexes for Exhibits 1 and 2" in the Index Descriptions section for more information. Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

Value has retained the lead over growth for the full year across all segments—and has either continued to grow its lead, or is near its widest performance margin of the period, everywhere except in U.S. large caps.

Why?

Growth's performance fell steeply in all four segments beginning in February. The pace of rising interest rates began to accelerate sharply during this period as economic growth prospects improved amid the earliest stages of reopening and expectations of higher inflation began to take hold.

Why did this weigh so heavily on growth stocks?

U.S. large-cap growth stocks are one of the most expensive areas of the stock market. When interest rates increase, the present value of future stock earnings—and stock valuations themselves—decrease. There's more room for valuations to fall when stocks are expensive based on their projected future earnings growth.

So why did growth stocks rebound so sharply from the spring to the summer in U.S. large caps (and, to a lesser extent, in small-cap and international developed markets)?

The surging COVID-19 Delta wave halted, or at least slowed, the reopening theme that had ignited the growth-to-value rotation in the first place. Many of the expensive technology-oriented stay-at-home growth stocks regained their relative appeal as the prospects for a full and fast return to normal life came into question.

We can see that the growth rebound faltered at the end of the summer, precisely when the crest of the Delta wave started to come into focus across the developed world.

Emerging-market stocks had a different experience altogether after growth performance began to suffer in early 2021. Why?

Rising inflation commands greater urgency in emerging markets, but the response is the same: central banks raise interest rates to defend the value and pricing power of their national currencies. Emerging-market central banks have been increasing rates in 2021 to stay ahead of rising price pressures.

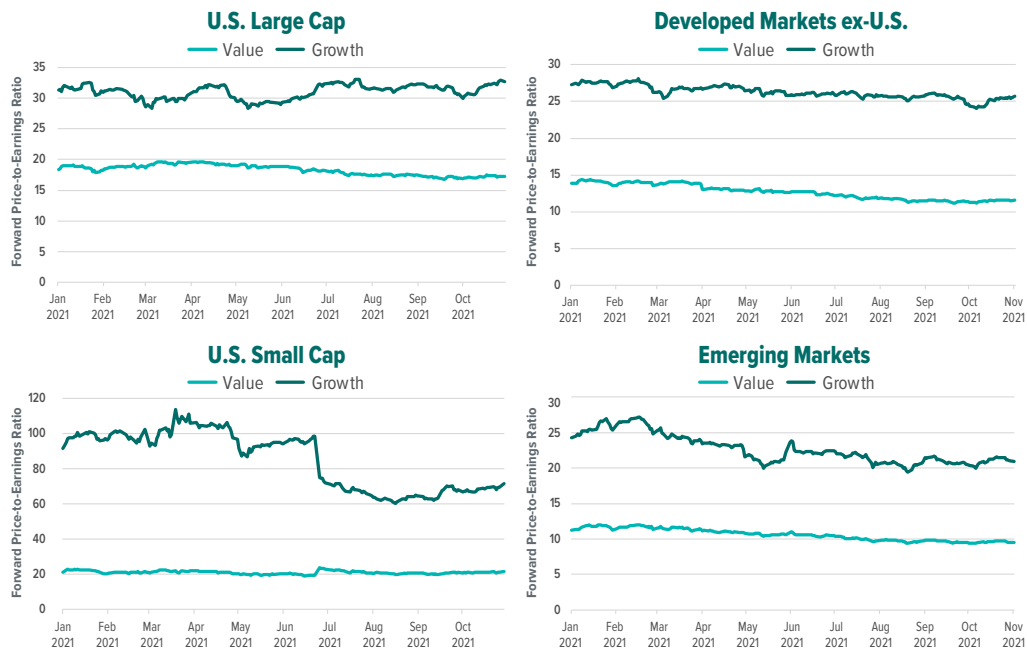
This contrasts sharply with the developed-market experience, where interest rates on government bonds declined significantly from early spring through mid-summer.

SEI's view

Valuations continue to tell the story. As Exhibit 2 shows, growth stocks remain much more expensive than value stocks. In fact, value stocks have actually become less expensive on a forward price-to-earnings basis as their earnings expectations improved alongside the reopening theme.

Coupled with growth's summer rebound, the valuation spread between value and growth has been essentially driven back to the historic extreme that existed prior to the rotation. In short, value is still quite cheap in relative terms.

Exhibit 2: Valuation Gaps Remain Remarkably Wide



Valuations based on a 12-month forward price-to-earnings ratio from January 1, 2021 through November 1, 2021. Sources: Bloomberg, SEI. See “Corresponding Indexes for Exhibits 1 and 2” in the Index Descriptions section for more information. Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

It's been a good year for value, but we believe it still has a long way to go versus growth. Our U.S. large-cap strategies continue to underweight (compared to their benchmarks) many of the largest growth stocks in favor of more attractively valued opportunities further down the capitalization spectrum.

We also expect international stocks to improve their relative performance. Exhibit 2 paints a picture of the valuation discount on offer in the developed ex-U.S. segment, and emerging markets are even cheaper.

Won't the greater rate hikes in emerging markets create challenges?

We believe investors are being paid to take the additional risk given the wide valuation gap. Recent outperformance by small caps and smaller Southeast Asian countries support our expectation that value will gain ground everywhere, not just in the U.S.

Glossary of Financial Terms

Growth: Growth stocks exhibit earnings growth above that of the broader market.

Price-to-earnings (PE) ratio: The PE ratio is equal to the market capitalization of a share or index divided by trailing (over the prior 12 months) or forward (forecasted over the next 12 months) earnings. The higher the PE ratio, the more the market is willing to pay for each dollar of annual earnings.

Value: Value stocks are those that are considered to be cheap and are trading for less than they are worth.

Index Descriptions

Corresponding Indexes for Exhibits 1 and 2	
U.S. Large Cap Value	Russell 1000 Value Index
U.S. Large Cap Growth	Russell 1000 Growth Index
U.S. Small Cap Value	Russell 2000 Value Index
U.S. Small Cap Growth	Russell 2000 Growth Index
Developed Markets ex-U.S. Value	MSCI World ex-USA Value Index
Developed Markets ex-U.S. Growth	MSCI World ex-USA Growth Index
Emerging Markets Value	MSCI Emerging Markets Value Index
Emerging Markets Growth	MSCI Emerging Markets Growth Index

MSCI Emerging Markets Growth Index: The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities that exhibit overall growth style characteristics.

MSCI Emerging Markets Value Index: The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities that exhibit overall value style characteristics.

MSCI World ex-USA Growth Index: measures the equity market performance of large- and mid-cap securities exhibiting overall growth style characteristics across developed-market countries, excluding the U.S.

MSCI World ex-USA Value Index: measures the equity market performance of large- and mid-cap securities exhibiting overall value style characteristics across developed-market countries, excluding the U.S.

Russell 1000 Growth Index: The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 2000 Growth Index: The Russell 2000 Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-value ratios and higher forecasted growth values.

Russell 1000 Value Index: The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

Russell 2000 Value Index: The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

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