MARKET INSIGHTS

from Ziegler Capital Management

"The Reports of My Death Are Greatly Exaggerated" – Value

WRITTEN: AUGUST 25, 2020

Over the past ten years, growth stocks have outperformed value stocks both in large cap (as measured by the Russell 1000 Growth and Russell 1000 Value, respectively) and particularly in small cap (as measured by the Russell 2000 Growth and Russell 2000 Value, respectively). Growth has outpaced value; 17.23% versus 10.41% on an annualized basis for large cap and 12.92% versus 7.82% for small cap as of June 30, 2020. On a calendar year basis through the end of 2019, growth has outperformed value in 7 of 10 years in large cap and 8 of 10 years in small cap.

Growth vs Value Over The Last 10 Years

10-Year Annualized Performance		In Favor Over The Last 10 Annual Periods									
SMALL CAPS											
Russell 2000 Growth	12.92%	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Russell 2000 Value	7.82%										
LARGE CAPS											
Russell 1000 Growth	17.23%	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Russell 1000 Value	10.41%										

As of June 30, 3030. Source: Bloomberg

Given the dramatic underperformance of value stocks relative to growth stocks over the past decade, it is understandable that investors question the continued validity of value investing. Value has faced similar death sentences in the past only to stage dramatic comebacks and once **again** remind investors why an allocation to value is an important part of a diversified portfolio. We emphasize "again" because this is not the first time that value investing has lagged growth.

Large cap growth companies are often talked about daily – the five largest companies in the Russell 1000 Growth as of July 31, 2020 are Microsoft, Apple, Amazon, Facebook and Google (both classes). People of all walks of life like to talk about their newest product or service. Value companies are typically less exciting – the five largest companies in the Russell 1000 Value as of July 31, 2020 are Berkshire Hathaway, Johnson & Johnson, JP Morgan, Verizon, and Pfizer. These companies also make or provide vital products or services (or invest in them like Berkshire Hathaway), but we may not talk about these companies with the excitement of the largest growth companies.

ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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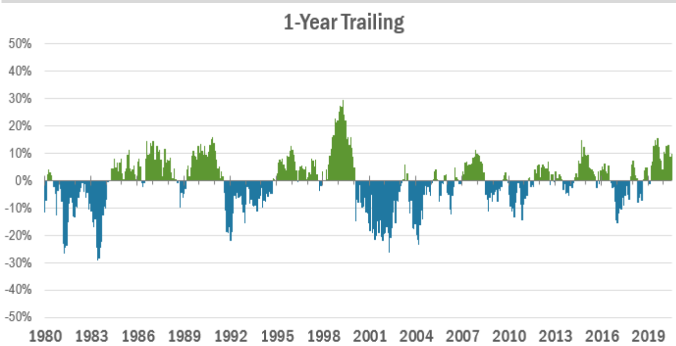
This scenario is just as pronounced in small cap investing, if not more. While the largest companies in both the Russell 2000 Growth and Russell 2000 Value may not ring a bell, the sector and underlying industry weights tell similar stories. As of July 31, 2020, the Russell 2000 Growth has a 34.3% weight to Health Care (including 17% to the biotech industry) and 18.3% in Technology, its largest sectors. In contrast, the Russell 2000 Value has 39.4% in Financials (banks are the largest industry at 17.7%) and 13.9% in Producer Durables for its largest sector.

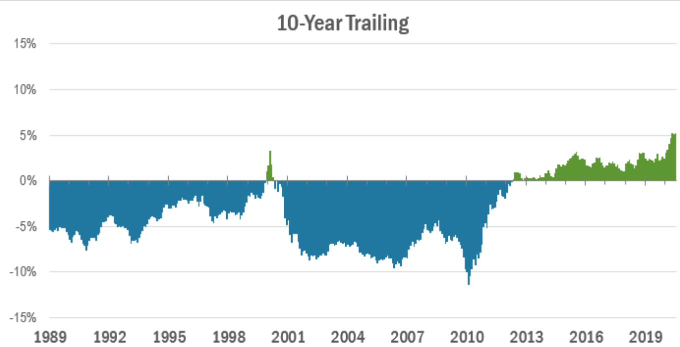
As of July 31, 2020, the rolling 10-year return of the Russell 1000 Growth was 17.29%. This is in far contrast to the 10.12% return of the Russell 1000 Value over the same period. This difference is evident in small cap as well – the Russell 2000 Growth has returned 12.58% and the Russell 2000 Value has returned 7.30%. Let us compare and contrast by observing Large Cap Growth versus Small Cap Value. The spread between the Russell 1000 Growth and the Russell 2000 Value is 9.99% - also extremely high.

Since comparative data has been available (the first rolling 10-year period began in January 1989), this is the largest that this spread has ever been in favor of the Russell 1000 Growth. However – it is interesting to note that this spread has actually been larger before, ***but in favor of the Russell 2000 Value***. This spread peaked at an all-time high of 13.21% in favor of small cap value on April 30, 2010. In fact, for 22 consecutive month-ending periods (between September 2008 and November 2010), it was never less than 9.00% in favor of the Russell 2000 Value.

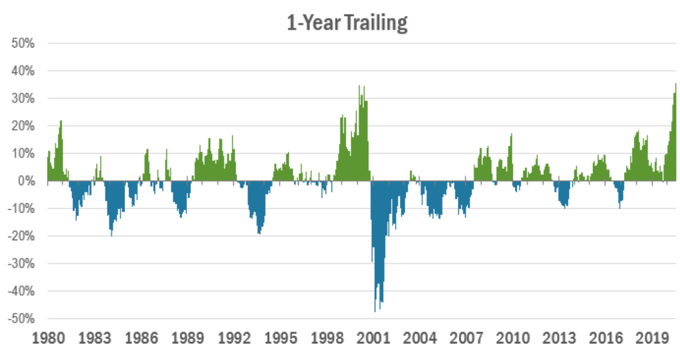
Trailing Return Spreads

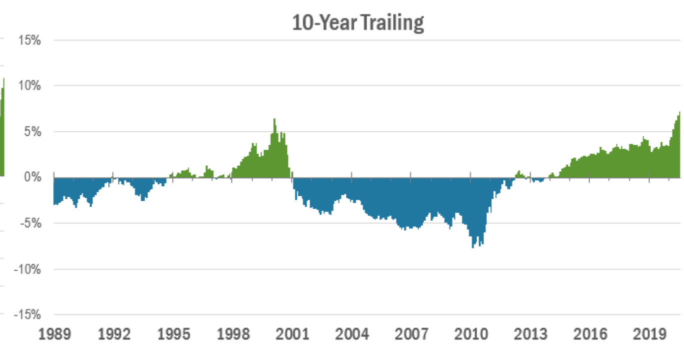
SMALL CAP Russell 2000 Growth In Favor Russell 2000 Value In Favor





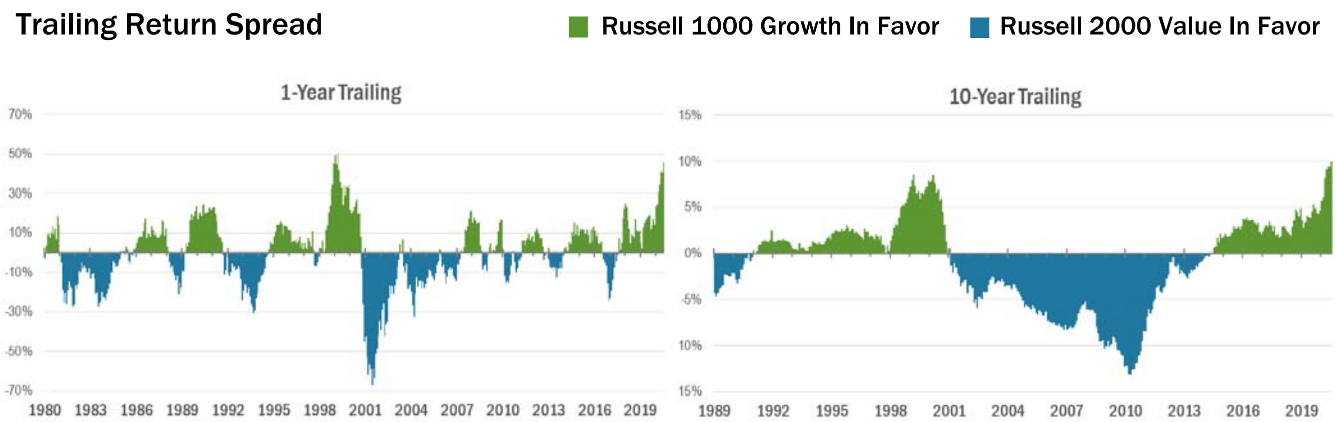
LARGE CAP Russell 1000 Growth In Favor Russell 1000 Value In Favor





Source: Bloomberg.

In narrowing down to a rolling 1-year time period, the Russell 1000 Growth outperforms the Russell 2000 Value by a whopping 45.75% as of July 31 (+29.84% for the Russell 1000 Growth and -15.91% for the Russell 2000). Has this spread ever been this extreme before? The answer is yes for the rolling one-year period ending March 31, 1999 when this spread favored the Russell 1000 Growth by 50.14%. (The Russell 1000 Growth returned +28.11% and the Russell 1000 Value returned –22.03%). What happened next? The late 1990’s tech bubble burst in spectacular fashion. This was followed by one of the longest runs of Value dominance that ran relatively unfettered until 2006. Interestingly, the most extreme period of this cycle was the trailing one-year period ending on June 30, 2001 – the spread was a massive 66.98% in favor of the Russell 2000 Value with the index returning +30.80% versus the Russell 1000 Growth returning -36.17%. This was only slightly more than two years after the extreme peak favoring Large Cap Growth investing.



Source: Bloomberg.

We point these facts out not for any investor to make a rash decision to put all of their assets into one basket – including any of the asset classes discussed in this piece. Rather, we think that investors who are ignoring value investing (and particularly small cap value investing) may be missing a potentially significant opportunity to rebalance or add this asset class to their portfolios at a market extreme. If market history is any guide, this may be a classic cyclical extreme between growth and value. Value is likely not dead; it may be taking a power nap to build energy for an extended day of activity.

ZIEGLER CAPITAL MANAGEMENT, LLC
70 West Madison Street | Suite 2400 | Chicago, Illinois | 60602 | www.zieglercap.com

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