



Ivey

Ben Graham Centre
for Value Investing

VALUE VS GROWTH INVESTING AND THE FUTURE OF STOCK PRICES

**Presentation at the Ben Graham Centre's 3rd European
Value Investing Conference**

October 13, 2023



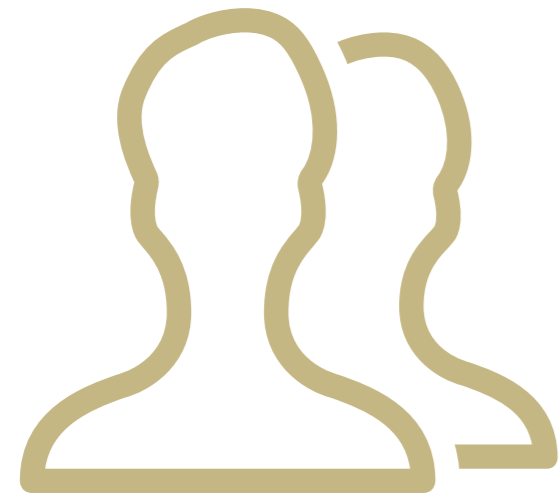
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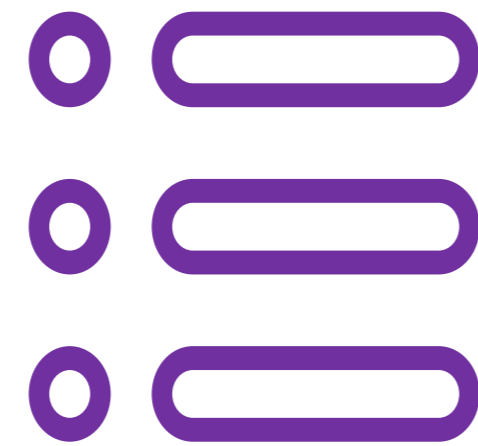


Value vs Growth Investing

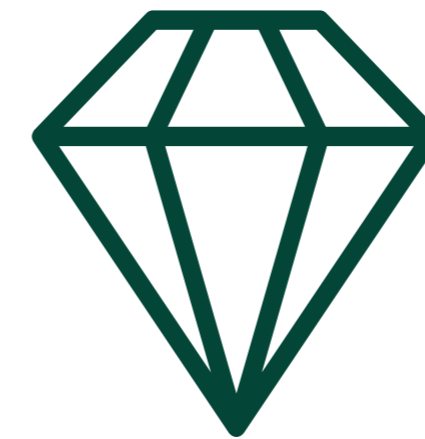
Outline



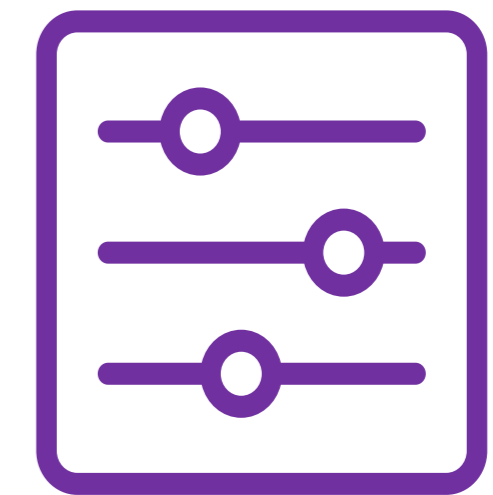
**WHO ARE THE
VALUE
INVESTORS?**



**WHAT PROCESS
DO THEY
FOLLOW?**



**DOES VALUE
INVESTING
WORK?**



**THE FUTURE OF
STOCK PRICES:
VALUE VS
GROWTH**

WHO ARE THE VALUE INVESTORS?

Approaches to Investing

- Long-Term
 - Fundamental Value - Bottom-Up Analysis
 - Market Price vs. Intrinsic Value
- Short-Term
 - Fundamental Value - Bottom-Up Analysis
 - Current Price
 - Forecast Change

WHAT PROCESS DO VALUE INVESTORS FOLLOW?

Value Investing in Practice

Step 1: The Search Process

- Look for Possibly Undervalued Stocks, Such as
 - Obscure and/or Undesirable Stocks
 - Small Cap Stocks
 - Low Analyst Following Stocks
 - Low P/E or Low M/B Stocks
 - Or, Companies With Sustainable Competitive Advantage
- First Step, not to be Confused With Final Stock Selection

Value Investing in Practice

Step 2: Valuation

- Value Investors Estimate Intrinsic Value by Looking at
 - A Company's Balance Sheet and the Replacement Value of a Company's Assets
 - The Value of a Company's Current Earnings and Earnings Power
- Only in Exceptional Cases Value Investors Factor in Growth

Value Investing in Practice

Step 3: Stock Selection

- Know What You Know
 - Not All Value is Measurable
 - Not All Value is Measurable by You
- Invest in Truly Undervalued Stocks
 - Look for Margin of Safety – Buy a Stock Only if its Market Price is Below an Entry Price, Where Entry Price is Equal to $\frac{2}{3}$ of Intrinsic Value
 - If no Undervalued Stocks are Found, Stay in Cash
 - Value Investing Implies Concentration
- Be Disciplined and Patient

DOES WHAT VALUE INVESTORS DO WORK?

Historical Records Confirm that Value Investing Works



Value Stocks Earn Higher Returns Than Growth Stocks

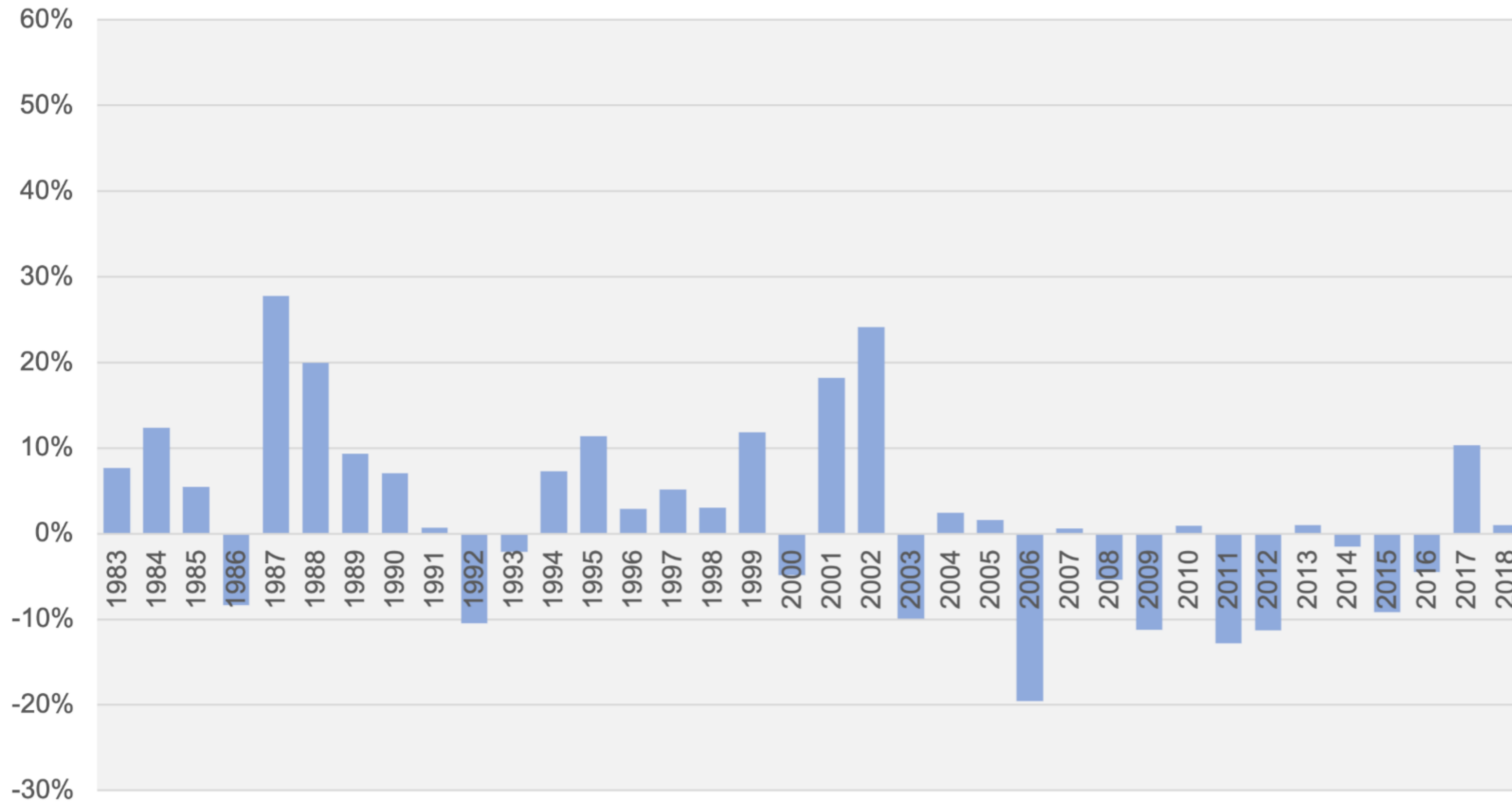


The Difference is Larger for Smaller Stocks, But Also Present in Large Stocks

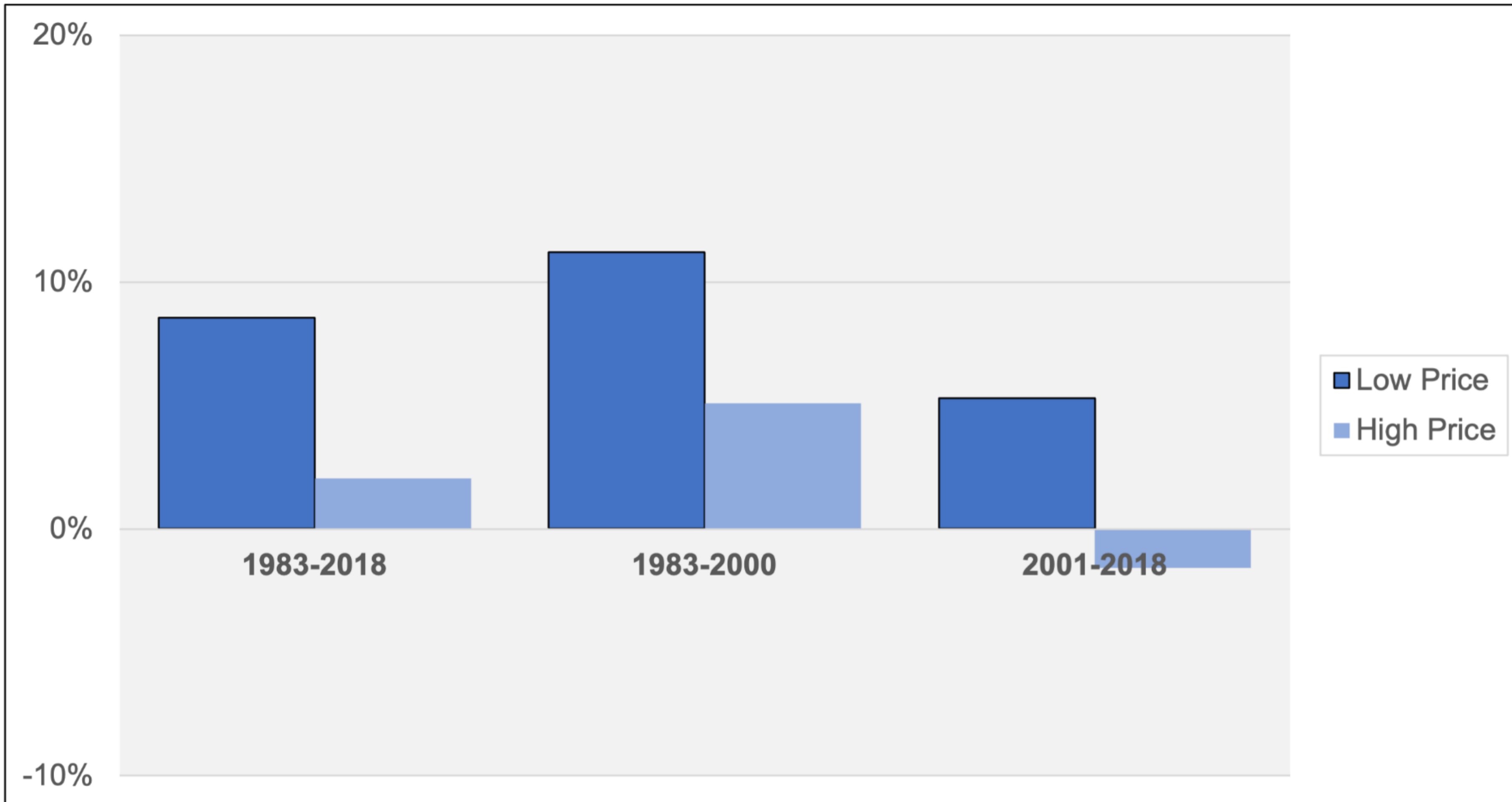


The Value Premium Exists Also in Equity Markets Around the World

P/B-based Canadian Value Premiums by Year, 1983-2018

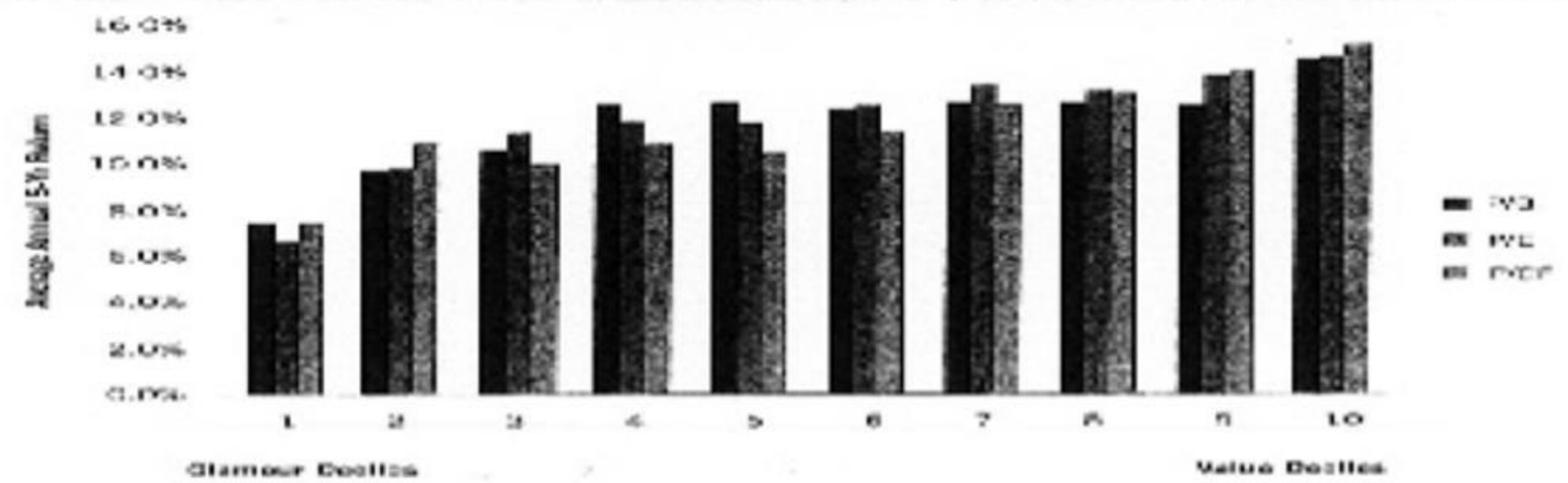


Canadian Value Premiums Based on P/B Ratio and Stock Price for 1983-2018 and Sub-Periods



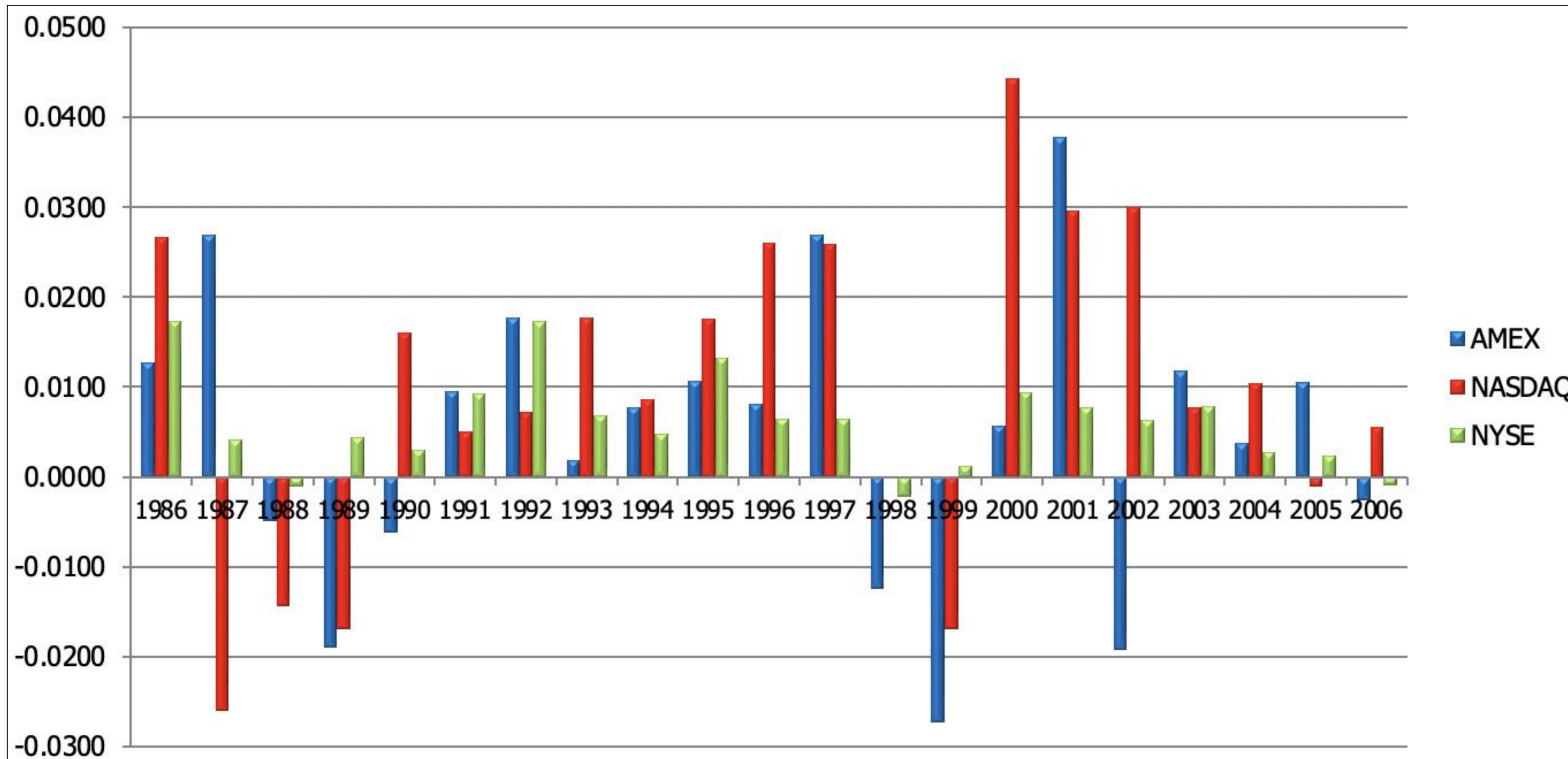
Value Investing in Global Markets: 1980-2014

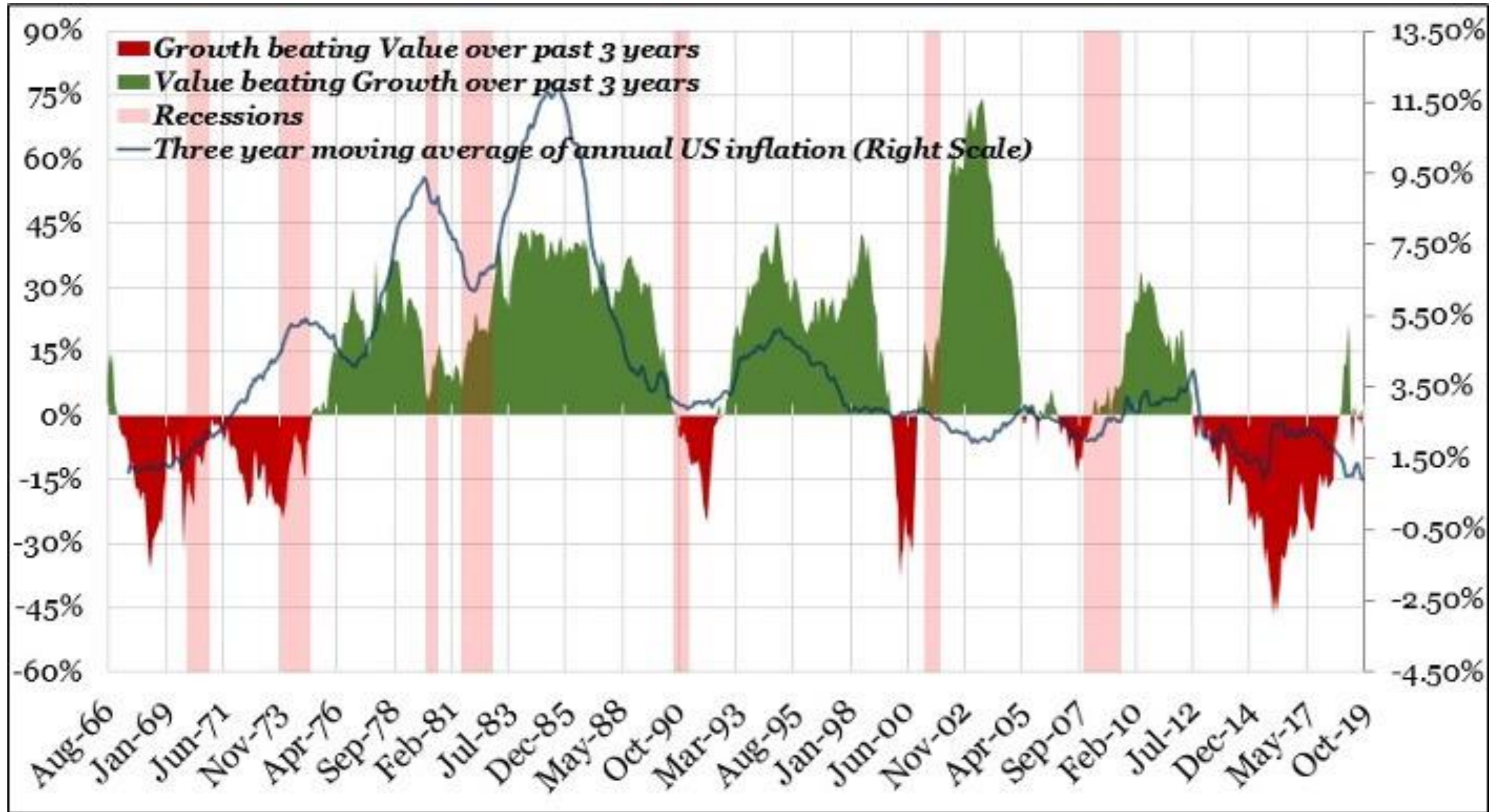
Exhibit 1: Value Outperformed Glamour Regardless of Valuation Metrics
 Rolling 5 Year Annualized Returns of Value vs. Glamour Deciles, International Large-Cap Sample, 1980-2014



Source: Worldscope via FactSet, Brucers Institute, as of 5/31/2014. Past performance is not a guarantee of future results. Stocks were divided into deciles based on their fundamentals (e.g., P/B, P/E and P/CV).

Mean Monthly U.S. Value Premiums to P/E Ratio Based Value and Growth Strategies by Year: 1986-2006





**US Annualized
Three-year
Average
Monthly P/B-
based Value
Premiums
Against a
Measure of 4
year Ahead
Expected
Inflation**

Inflation and the Value Premium: A historical Perspective

- During the Cold War years between 1966 and 1991 – with U.S. inflation averaging 4.3 per cent annually – value stocks outperformed growth stocks by 10.8 per cent per annum,
- Between 2008 and 2020 – when inflation averaged only 1.7 per cent – growth outperformed value by 4.2 per cent.
- Over longer periods too, i.e., Between 1930 and 2020
 - The ten-year periods with the highest inflation were: 1940-1950, 1970-1980 and 1980-1990. The median value premiums were 7.56%, 9.96% and 13.93%, respectively.
 - The ten-year periods with the lowest inflation were: 1930-1940, 1950-1960 and 2010-2020. The median value premiums were -2.10%, 1.98% and -2.70%, respectively.

The Future of Stock Prices: Historical Overview

- The fall of the Berlin Wall, the break-up of the Soviet Union and the end of the Cold War in 1989-91 ushered in the new era of globalization. The admission of China to the World Trade Organization in 2001 completed the picture.
 - Globalization shrunk the world.
- As a result of globalization, many citizens in the developed world were displaced by the labour force of China and India. Manufacturing jobs disappeared in developed countries at an alarming rate, and moved to developing countries.

The Future of Stock Prices: Historical Overview, Cont'd

- An increased pool of cheap labour from China and India drove wages down, or prevented them from rising.
 - Moreover, increased economic integration or openness led to weakened workers' bargaining power.
- Tax friendly government policies helped reduce corporate taxation.
- Increased global trade, lower labour costs and reduced taxation helped keep inflation low and by extension interest rates and benefited bonds, and real estate, but more directly stocks.
 - S&P 500 profit margins rose sharply from around 6% in 2000 to close to 10% in 2019.
 - Stock prices and profit margins are highly correlated.

The Future of Stock Prices: What is Next?

- The secular trend toward globalization has ended with predictable adverse (long term) effects on inflation, and interest rates, as well as on bonds, real estate and stocks.
- Notice similarities with previous end-of-era periods of globalization:
 - A pandemic that has been likened to a war, challenges to globalization by large players such as Russia and China, and rising protectionism, economic instability, and galloping inflation.
 - Covid-19 has brought forth a new wave of nationalism in the world with industries moving back to their home countries as seen with Japan and the US.
 - Wars tend to lead to an end of, or challenges to, globalization. The events in Ukraine are auguring a new Cold War and will further challenge globalization.

The Future of Stock Prices: What is Next?

Cont'd

- Global trade is on the decline.
- The effect of China on globalization benefits is also eroding.
- A recent survey of 260 global supply chain leaders by Gartner found that 33% of them had already moved or planned to move manufacturing out of China (to a higher cost environment) in the near future.
- The surge of new manufacturing in North America is increasing the demand for labour, and since there are not enough workers around to fill the jobs, wages are rising at the fastest pace in four decades.
 - Workers and unions in this environment are regaining their lost bargaining power. Recent wage settlements support this view.

The Future of Stock Prices: What is Next?

Cont'd

- The era of declining taxation is also over. Going forward,
 - Pandemic related deficits and ballooning debts will require higher taxes.
 - Fewer workers to support retired people will also require higher taxes.
- Years of underinvestment in the oil & gas industry, heavy regulation and the ESG craze have shifted not only the oil price dynamics, but also that for all commodities.

The Future of Stock Prices: What is Next?

Conclusion

- Profit margins will be eroded going forward. Inflation will also be higher than what prevailed in the past and so are nominal interest rates.
- Nominal interest rates change not only when expected inflation changes, but also when real interest rates change.
 - In the long run, real interest rates are on the way up, too.
 - Demographic developments are pushing the real interest rate trend higher. Baby boomers have been retiring and have stopped saving; in fact, they are in their “decumulation” years, which reduces the supply of funds.
 - This happens in the face of increased demand for capital by corporations that need to embed innovation and new technologies into their production processes, as well as by governments that need to borrow to fund structural deficits.
 - To clear the demand-supply imbalance, the real interest rate trend is pushed up, not unlike what had happened in the late 1970s.

The Future of Stock Prices: What is Next?

Conclusion

- The effect of higher interest rates on stocks along with the erosion of profit margins will be predictably negative in contrast to the positive effect that lower interest rates and higher profit margins had on stocks over the last 30 years.
- The outlook appears particularly unfavourable for growth stocks, which will be hurt the most by de-globalization and higher inflation/interest rates.
- Growth stock underperformance will also have an adverse effect on the whole market as the share of the technology sector in market indexes has increased steeply in recent years.
- This does not mean that individual stocks will not do well. Stock picking and fundamental analysis will be key to outperformance going forward.
 - Value will outperform growth.
 - Riding the ETF bandwagon will not work.

What is the Secret of Outperformance of Value Stocks? Is it Higher Risk?

Bottom line

- Investors are over-pessimistic about value stocks. Some of these stocks indeed go bankrupt, but most do not and those that do not tend to do better in the future as investors were excessively pessimistic, and vice versa for growth stocks.
- In other words, value beats growth not necessarily because value does so well but rather because in the long run growth does so poorly.

Is Extra Return Reward for Extra Risk?



NO EVIDENCE TO SUPPORT THIS



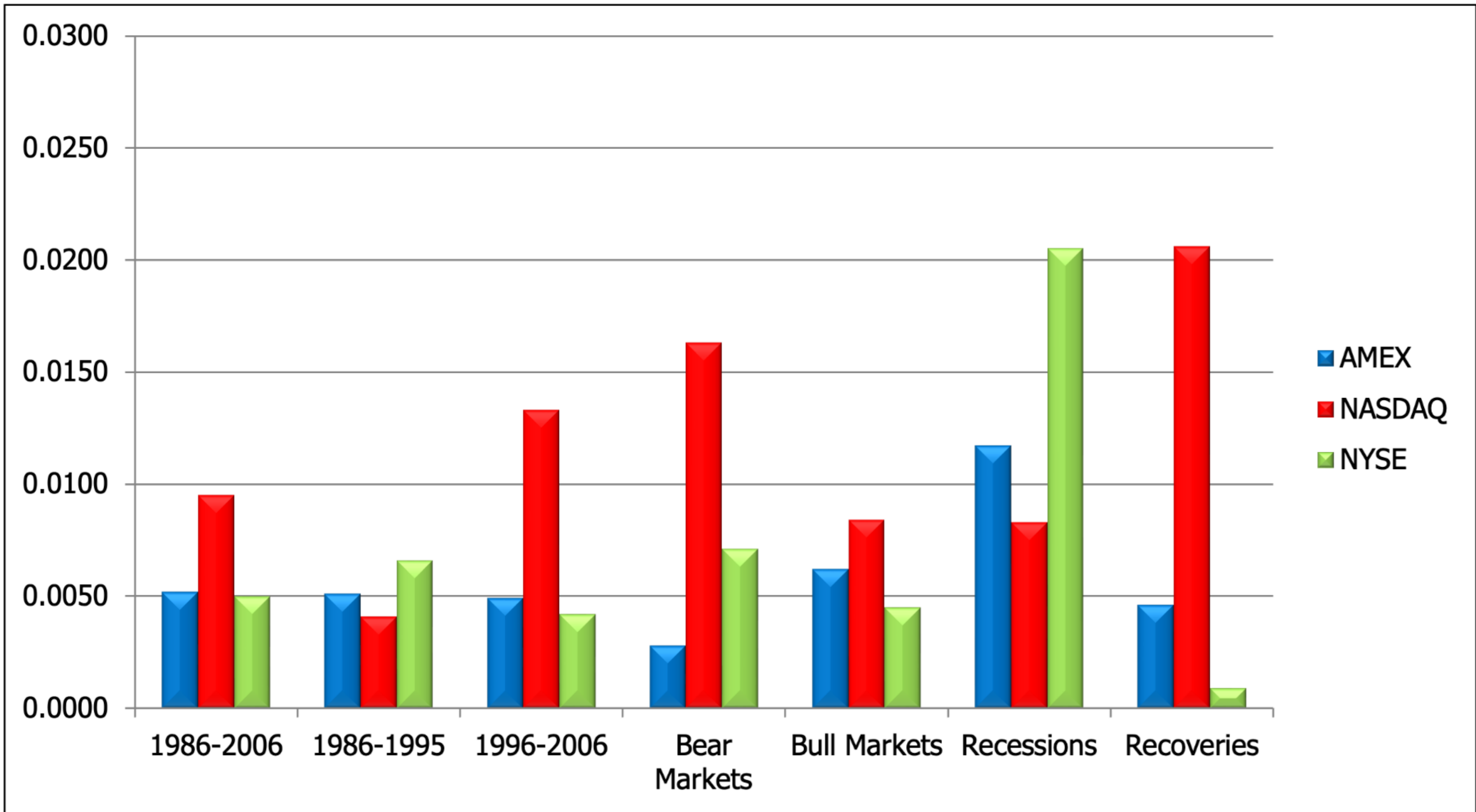
ANNUALIZED STANDARD DEVIATION OF RETURNS OR BETA OF VALUE PORTFOLIOS ARE SIMILAR TO (OR LOWER THAN) THOSE OF GROWTH PORTFOLIOS



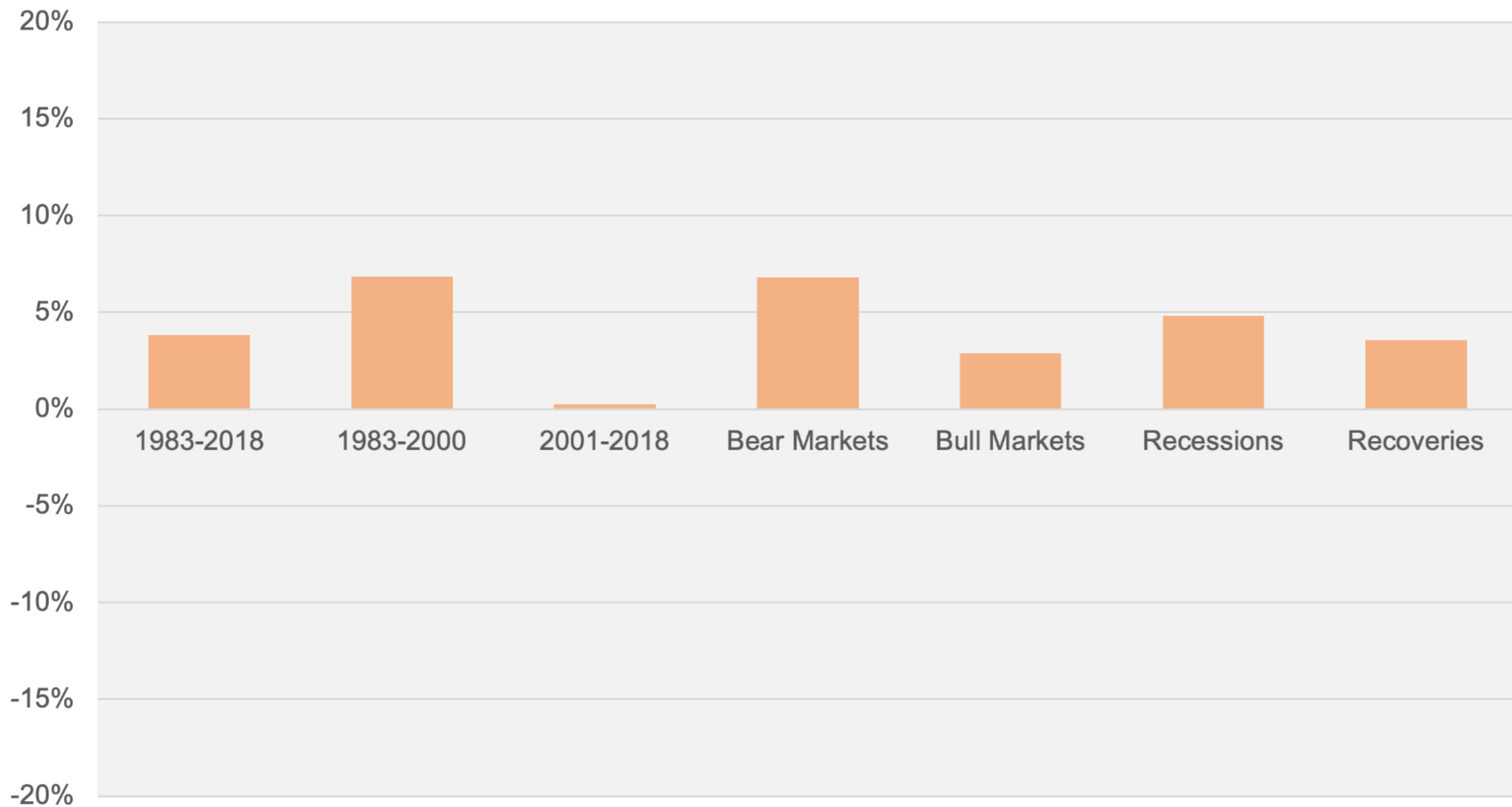
VALUE PORTFOLIOS FALL LESS IN VALUE IN REACTION TO BAD NEWS, IN BEAR MARKETS OR IN TERMS OF MAX LOSS



VALUE PORTFOLIOS HAVE OUTPERFORMED IN EVERY MARKET OR ECONOMIC SCENARIO



**Mean Monthly
U.S. Value
Premiums to
P/E Ratio
Based Value
and Growth
Strategies by
Sub-periods
and State of
the World:
1986-2006**

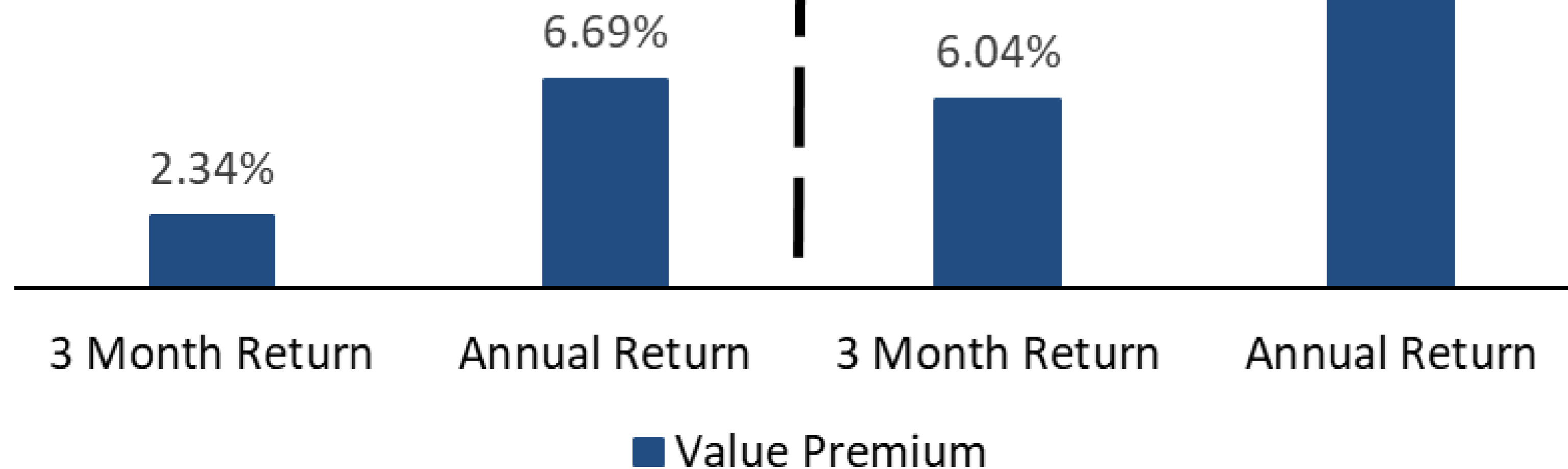


**P/B-based
Canadian
Value
Premiums by
Sub-Periods
and State of
the World:
1983-2018**

Value Premium

Positive Earnings Surprise
by 10%

Negative Earnings Surprise
by 10%



**P/B-Based US
Value
Premium (%)
to Positive and
Negative (at
least +/-10%
from
Expectations)
Earnings
Surprises:
1980-2018**

**CONCLUDING
REMARKS:
ADVICE FOR
INVESTING
SUCCESS**



**To be
Successful
as an
Investor,
you
Need**

REASONABLY GOOD INTELLIGENCE

- Simple, but not Easy

SOUND PRINCIPLES OF OPERATION

- You Need to Understand the Business You are Buying
- Be Disciplined and Patient
- Unless You are Willing to Put a Lot Into an Investment, You Should not Expect to Get Much Out of it

FIRMNESS OF CHARACTER

- Understand Human Weaknesses, See Them in Yourself, Correct Them or Develop Strategies to Deal with them
 - Look Before you Jump
 - Think of the Opposite
 - Be Analytical, Independent and Do your Homework
 - Have a Check List and Talk to a Knowledgeable Friend



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