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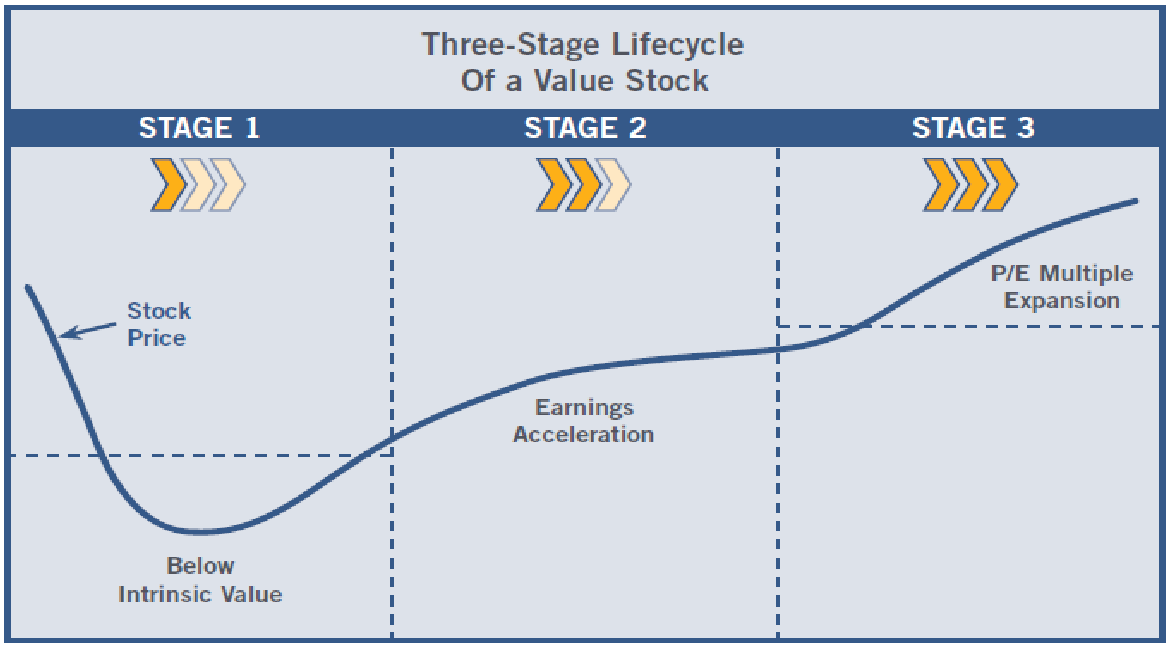
The Long-Term Value of Value Investing

Stocks that Value managers purchase may have these traits:

1. Attractive Valuation – Low Price/Earnings, Low Price/Cash Flow, Low Price/Book Value
2. Analysis of 'Intrinsic Value' (Private Market Value of Firm) > Current Market Price
3. Catalysts for Multiple Expansion – Specifically forecasted reasons/events that will trigger a positive market reaction to the stock, narrowing the gap to true intrinsic value
4. Avoid 'Value Traps' – Fundamental review of management, business strategy/competition, earnings & estimates, insider ownership by company officers, and possibly technical analysis may all be utilized in order to avoid fundamentally challenged companies on their road to obsolescence (aka a 'falling knife').



Source: Wasatch Advisors. This is a hypothetical representation of the three-stage lifecycle of a value stock. To value investors, a stock's intrinsic value is what is believed to be its "actual" value, based on examination of the company's fundamentals. There is no guarantee that a value stock's price will increase.

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Recent Underperformance of Value Style

As of 3/31/18	3 Year	5 Year	10 Year
Russell 3000 Growth	12.57	15.32	11.31
Russell 3000 Value	7.87	10.71	7.84
MSCI EAFE Growth	6.73	7.14	3.44
MSCI EAFE Value	4.30	5.78	1.97
MSCI EM Growth	10.89	7.30	3.87
MSCI EM Value	6.65	2.57	2.07

As of 3/31/18		3 Year	5 Year	10 Year
Russell 3000 Technology	Growth-Oriented	18.79	20.09	13.91
Russell 3000 Health Care	Growth-Oriented	5.66	14.49	12.84
Russell 3000 Consumer Discretionary	Growth-Oriented	10.51	14.23	13.45
Russell 3000 Financials	Value-Oriented	12.45	14.17	6.48
Russell 3000 Energy	Value-Oriented	-2.83	-1.69	0.35

Over the past 10 years, Value-centric sectors such as **Financials** (post-GFC, increased regulations, low interest-rate environment) and **Energy** (collapse in oil & natural gas prices/pressure on earnings/reduced dividends) have materially lagged Growth-centric sectors such as **Info Technology**, **Health Care**, and **Consumer Discretionary**. Low secular growth led to a premium being paid for fast-growing companies.

U.S.: "FANG" Stocks (Facebook, Amazon, Netflix, Google) – Over the past 3 years (as of 3/31/18), these stocks are up +25%, +57%, 71%, and 24% (on an annualized basis). Russell 3000 Technology sector is +20% over the past 3 years, materially exceeding more value-oriented sectors and the overall, broad Russell 3000 (+10%).

Emerging Markets: Chinese Internet Stocks (Alibaba, Tencent) – Over the past 3 years (as of 3/31/18), these stocks are up +30% and +41%. The MSCI EM IT sector has returned +18% over the past 3 years, versus +9% for the overall MSCI EM (including value-heavy Financials at +8%).

Historical Results – Worldwide Excess Return of Value Stocks vs. Growth

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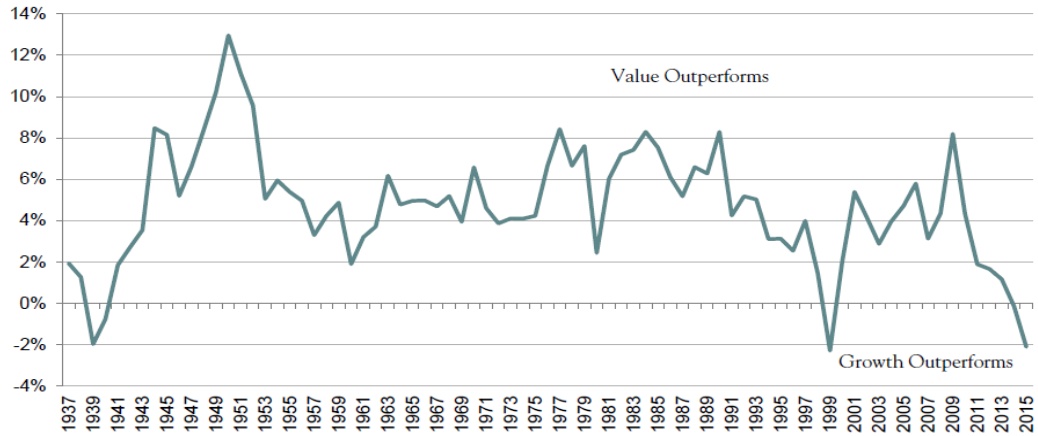
Long-Term Value Stocks have Clearly Outperformed Growth in the United States…

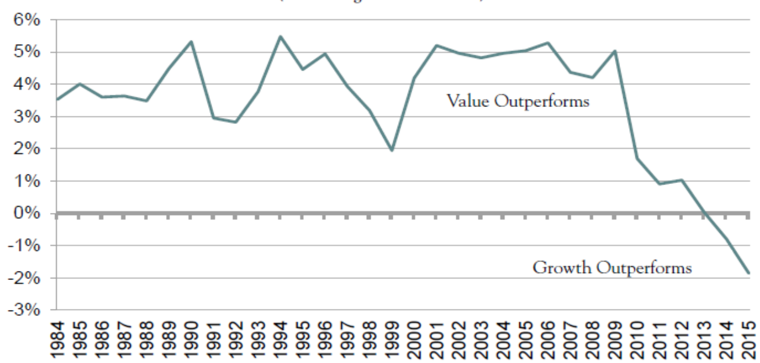
Rolling 10-Year Total Return Difference: Fama-French HML (Value vs. Growth)



Source: Kenneth French's Data Library.

…in the Developed World (ex-U.S.)…

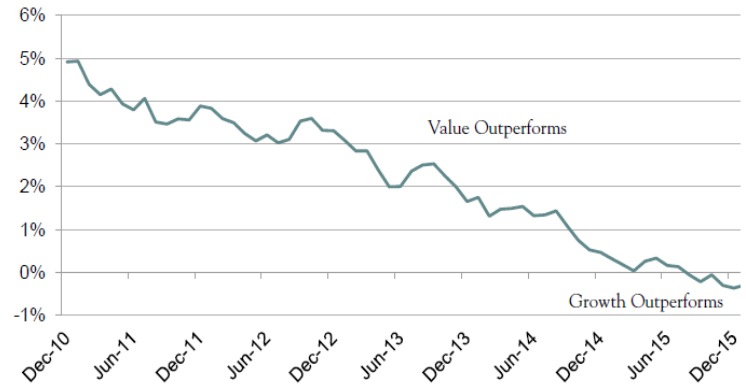
Rolling 10-Year Total Return Difference:
MSCI EAFE Value Index vs. MSCI EAFE Growth Index
Developed World
(excluding United States)



Source: MSCI.

…and Emerging Markets.

Rolling 10-Year Total Return Difference:
MSCI Emerging Markets Value Index vs. MSCI Emerging Markets Growth Index[e]



Source: MSCI.

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Why Has Value Outperformed Over Long Periods?

Behavioral Biases

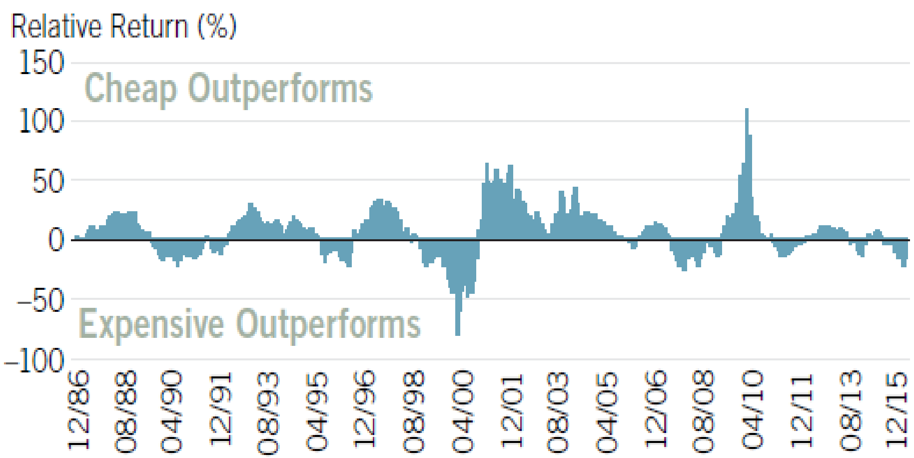
Stocks that trade at low valuation multiples tend to be associated with a company or industry with decelerating fundamentals, lower growth, and unexciting prospects – thus, companies that simply meet lowered expectations can outperform.

During times of heightened macroeconomic and/or market stress, many investors no longer look beyond the short-term and seek safety, furthering the discount to value stocks. When worst-case scenarios do not play out, there can be an aggressive snap-back in prices.

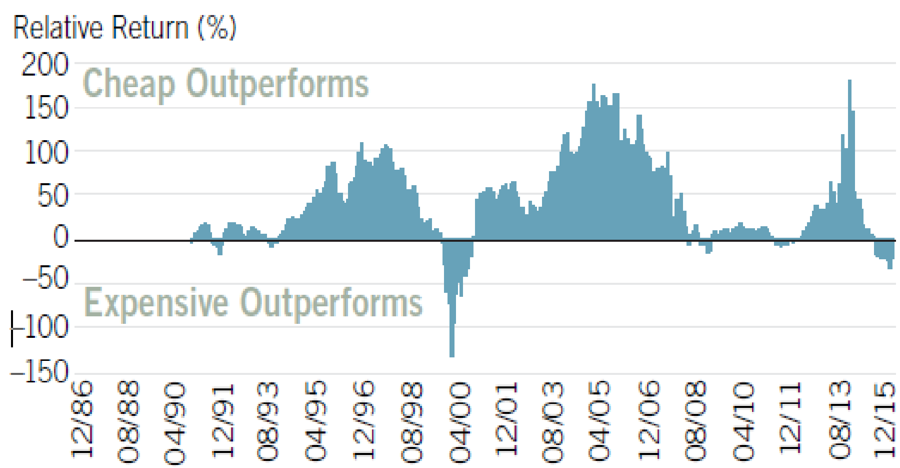
Return to Fundamentals

Owning the ‘cheapest’ stocks from a valuation perspective over the long-term has typically paid off, as through time securities tend to converge to their ‘true’ value. While choppy over one-year periods, over five-year periods the dominant performance of the value style is displayed:

One-Year Rolling Returns of Cheap vs. Expensive Stocks in Russell 3000 Index (1985–2015)



Five-Year Rolling Returns of Cheap vs. Expensive Stocks in Russell 3000 Index (1985–2015)



Source: Fidelity

Importance of Dividends

"The prime purpose of a business corporation is to pay dividends regularly and, presumably, to increase the rate as time goes on."
-Benjamin Graham, Security Analysis, 1934

All equity securities listed on NYSE, Amex, NASDAQ, and NYSE Arca during time period:

Hypothetical Growth of 1 Million From January 1928 – December 2017

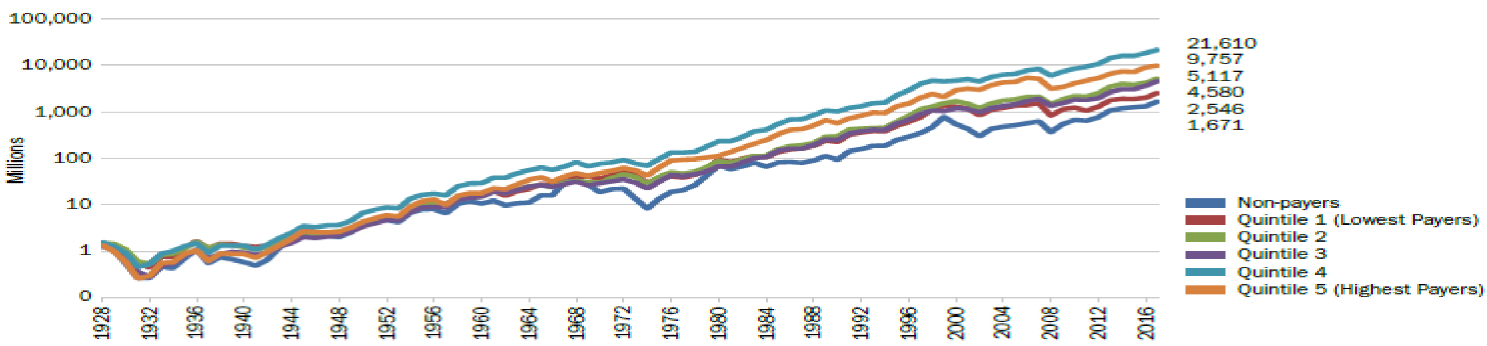


Table 1	Non-Payers	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Average Annual Total Return	8.60%	9.10%	9.95%	9.82%	11.73%	10.75%
Annualized Standard Deviation	33.12	22.61	19.21	20.51	20.97	23.81
Sharpe Ratio	0.16	0.25	0.34	0.31	0.39	0.31

Source: Kenneth R. French© and CRSP, 1/1/1928 - 12/31/2017

Dividend payers provide better Downside Protection:

Table 5: Average Cumulative Returns Over Various Ranges of Market Drawdowns

	Non-Payers	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
> = 30%	-44.97%	-38.11%	-32.89%	-32.05%	-29.91%	-32.37%
25 to <30%	-39.71	-27.97	-26.55	-32.07	-28.99	-30.81
20 to <25%	-33.31	-24.50	-20.82	-20.77	-19.61	-21.45
15 to <20%	-26.63	-17.85	-14.66	-12.29	-11.39	-11.14
10 to <15%	-20.15	-13.51	-12.28	-11.24	-10.90	-11.03
All Drawdowns	-28.24	-20.25	-17.68	-17.04	-15.99	-16.68

Source: Kenneth R. French© and CRSP, 1/1/1928 - 12/31/2017

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Conclusion

The time could be right for Value stocks, particularly those selected by diligent active managers, to re-emerge as market leaders – investors may recognize that the share prices of sound but deeply discounted companies offer substantial upside potential.

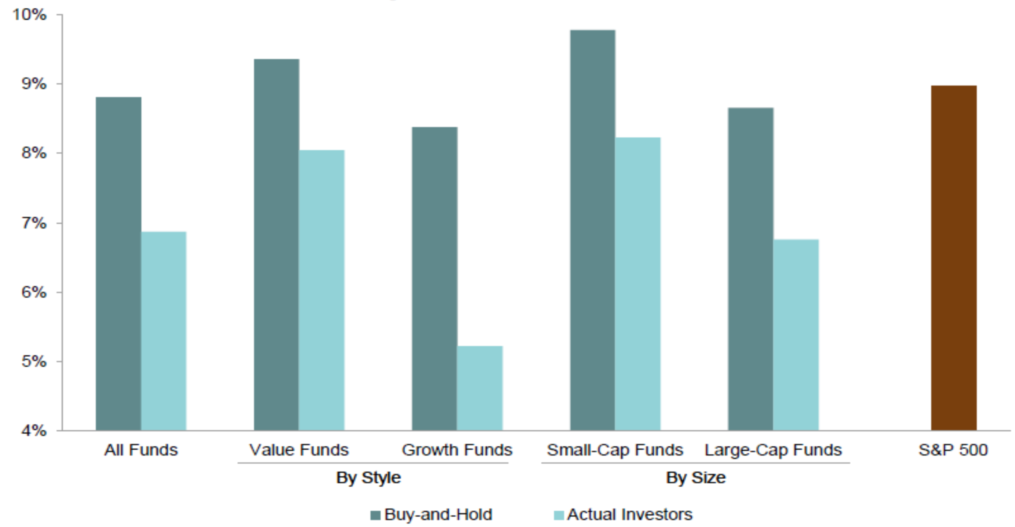
- ‘This time is different’ is an anthem that has led many investors astray in the past. An idea that value-style investing is a relic of the past will likely be proven false.

- Without deliberate corrective action (strategic plan/re-balancing) a material under-allocation to Value equities within a portfolio allocation may have resulted because of recent underperformance.

- Passive products (which are market-cap weighted) have dominated active managers over recent years in large part due to outperformance of a few growth/momentum stocks – should this tide turn (with individual securities referenced on page 3 lagging, for example), passive investors could face sharp declines, or at least underperformance versus active strategies.

- Chasing past returns (jumping into a security, style, or asset class following a run of good performance) has led the average U.S. equity investor to underperform the average mutual fund’s published return by approximately 2% on an annualized basis:

U.S. Equity Mutual Funds: Returns Realized by Type of Fund (Net of Fees)
Monthly Data Compounded to Annual Periods (1991 to 2013)



Source: Hsu, Jason, Brett W. Myers, and Ryan Whitby. “Timing Poorly: A Guide to Generating Poor Returns While Investing in Successful Strategies.”

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