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"Value investing might never come back"

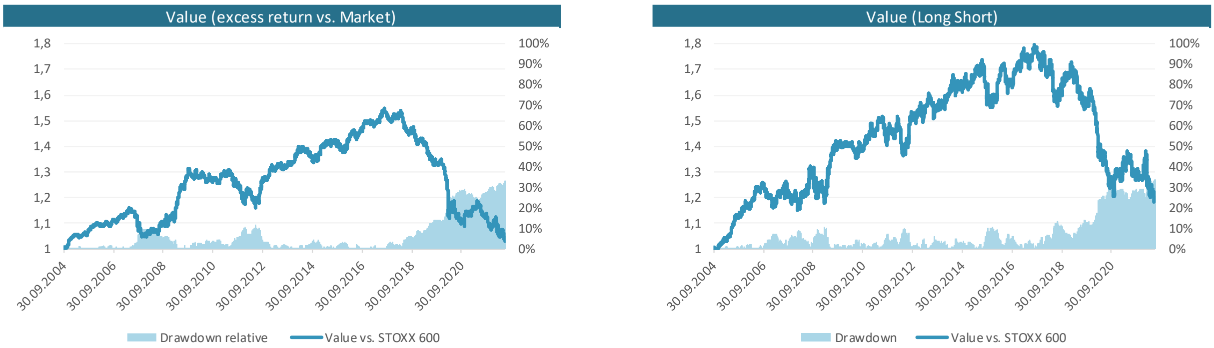
…. has been a recent Bloomberg headline of an interview with Greenlight Capital´s David Einhorn, in which he stated, that "I don't know that it ever comes back". But on the other hand, he stated: "So **there's an enormous number of companies that are dramatically mis-valued in ways that we haven't seen before**."

Einhorn is not the first, asking the question, if Value investing has come to an end over recent years. In a working paper entitled **"Reports of Value's Death May Be Greatly Exaggerated"** from 2019, Arnott, Harvey and Kalesnik (SSRN link) took a closer look at intangibles and concluded: "The underperformance leads many to argue that value is dead. Our analysis attributes value's recent underperformance to two sources: the HML book-value-to-price definition fails to capture the increasingly important intangible assets, and valuations of value stocks relative to growth stocks have tumbled. Both arguments are inconsistent with value's death arguments."

Fama and French themselves took another look at their work on Value in 2020 in **"The Value Premium"**, (SSRN link) in which they tried to "determine whether expected value premiums – the expected differences between value portfolio returns and the VW [value weight] market return – decline or perhaps disappear".

Last but not least, Israel, Laursen and Richardson asked the question in 2020, **"Is (Systematic) Value Investing Dead?"** (SSRN link) and concluded: "While undoubtedly many systematic approaches to value investing have suffered recently, we find the suggestion that value investing is dead to be premature. Both from a theoretical and empirical perspective, expectations of fundamental information have been and continue to be an important driver of security returns. We also address a series of critiques levelled at value investing and find them generally lacking in sub-stance."

It´s certainly true, that Value as a factor had one of its steepest phases of underperformance compared to market benchmarks on both sides of the Atlantic over the last couple of years. The same is true for Value Long/Short. Nevertheless, Value´s decline started much later, than ancient families of growth and value indices measures imply. "Purified" Value had a decent run since the end of the TMT bubble, only interrupted by the Financial Crisis in 2007/2008, as well as the Euro-and Greece crisis in 2011 and 2015. But on average, Value outperformed until 2017/2018, depending on the way of implementation (relative to market or Long/Short).

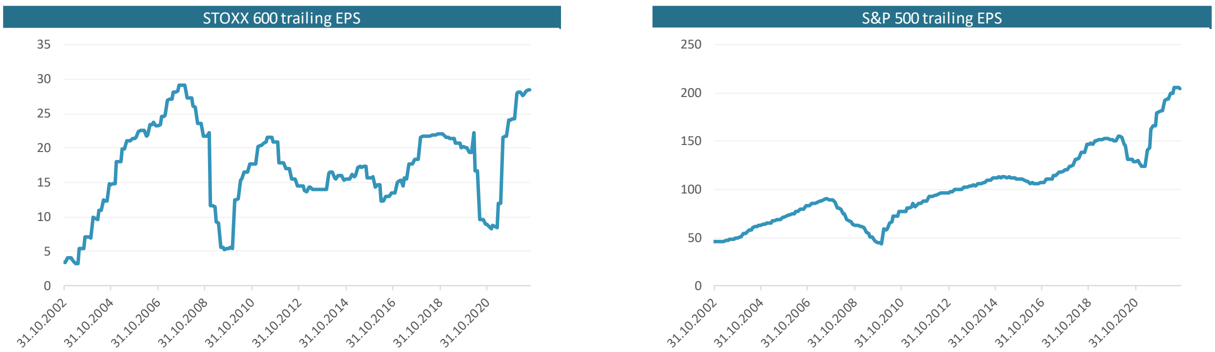


Graph 1: Value Europe vs market (lhs); Value Europe Long/Short (rhs), Source S&P Global, AC calculations

The fact, that Value underperformed during these three episodes shouldn´t come as a surprize. In one of our publications of 2019 entitled "Value stocks behave like Long Call options…" (AC link), we elaborated on the drivers of Value, stating that **"the most important driver of (excess-) returns of value stocks is earnings growth."**

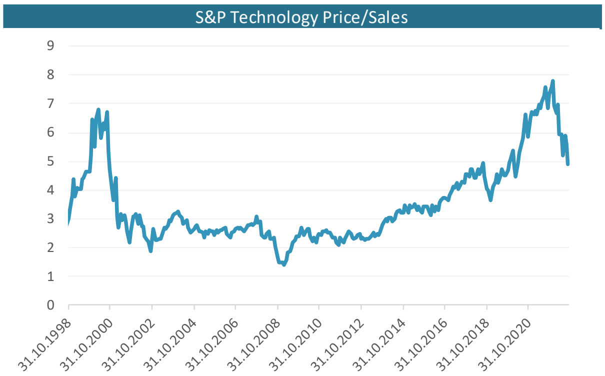
Looking at aggregate index earnings in Europe it becomes clear, why Value in Europe exhibited difficult times over the last couple of years. **Trailing four quarter earnings of STOXX 600 are more or less on the same level as they have been in 2007.** Moreover, the phases of Value´s underperformance during 2007/2008, 2011 and 2015 as well as the recent episodes during 2018, the Corona Crisis and the current slowdown are a confirmation of our view from 2019.

Our argument regarding the earnings cycle as the most important – which implies not the only by the way – driver of Value returns might become less valid when looking at developments in the US, where earnings increased materially over the last 20 years. Nevertheless, when looking across sectors, it becomes clear, that earnings growth has been unevenly spread.



Graph 2: STOXX 600 Europe trailing 4Q EPS (lhs); S&P 500 trailing EPS (rhs); Source Bloomberg, AC calculations

The "other side of value" – apart form earnings and cashflows - are discount factors and lower **interest rates are not only favourable for long duration bonds but for all sorts of long duration assets** as many papers have shown over the last couple of years. And as growth stocks exhibit higher valuations, their "duration" is much longer than those of value stocks, even more so, when valuations rise to stratospheric levels as we have seen during recent advances of Tech stocks.



Graph 3: S&P Technology sector price/sales ratio; Source Bloomberg, AC calculations

Conclusion:

From our point of view, **value will be under pressure if earnings are a scarce commodity**. Rising yields might be a drag on growth stocks and in this sense more favourable for value stocks in a relative sense. If the economic situation in Europe will be as it is today – lower growth expectations accompanied by higher inflation rates – investors might be better off with staying away from both and direct their factor exposures towards Low Risk and Quality for a while. iSTOXX factors and associated EUREX futures are a convenient way to implement index relative as well as relative factor long and -short trades.

Nevertheless, when looking at the second of Einhorn´s statements mentioned above, it´s difficult to believe, that "this time is different" and the misvaluation of many companies will never be corrected again. Economic history tells a different story.

Factor performance

Defensive factors like Low Risk and Quality continued to outperform Size and Value during Q3/2022 which is consistent with the current economic environment. US factors showed the same pattern – Low Risk and Quality outperformance vs. Value and Size underperformance.

Alpha Centauri Indexing - Data as of 30.09.2022

Description:

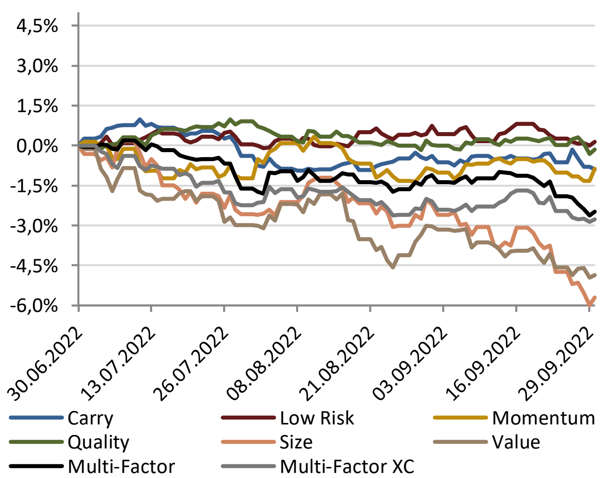
The iSTOXX Europe Single Factor index family developed by STOXX in collaboration with Alpha Centauri offers investors a unique and very innovative way to target and capture premia.
It consists of six single factors that aim to capture well-known risk premia and one multi-factor that aims at simultaneously capturing premia from the aggregate of all single factors rather than from just one source of risk alone.
All indices are constructed to maximize the exposure to their particular factor and minimize unwanted risks. While constructing the final indices the FIS APT risk model is used to measure and restrict risk.

For more information go to **www.alpha-centauri.com** or **www.stoxx.com**

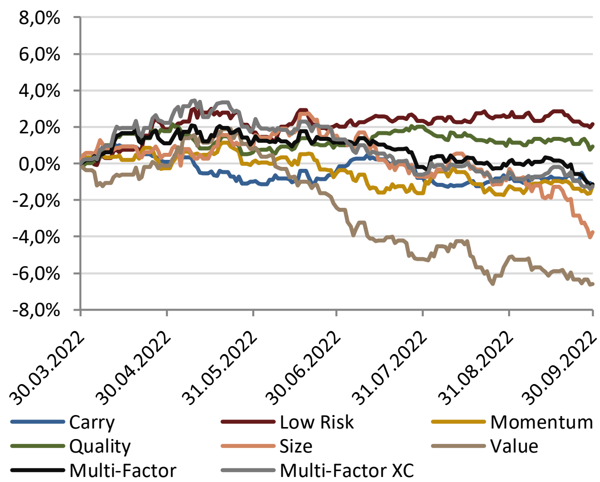
Performance and Volatility Breakdown

Name	Ticker	Return 3 Months	Return 6 Months	Return 12 Months	Return Live (1.4.)	Vola pa	Vola pa Live (1.4.)
Carry	ISECFER Index	-5,2%	-15,4%	-13,8%	47,5%	14,3%	14,0%
Low Risk	ISERRER Index	-4,2%	-12,1%	-7,3%	48,0%	13,4%	13,1%
Momentum	ISEMFER Index	-5,2%	-15,5%	-16,1%	31,8%	14,1%	13,8%
Quality	ISEQFER Index	-4,5%	-13,3%	-12,8%	37,7%	14,1%	13,8%
Size	ISEZFER Index	-10,0%	-18,0%	-17,2%	31,0%	13,9%	13,7%
Value	ISEVFER Index	-9,2%	-20,8%	-24,1%	-6,7%	15,3%	14,9%
Multi-Factor	ISEXFER Index	-6,8%	-15,4%	-13,8%	26,3%	13,5%	13,2%
Multi-Factor XC	ISEXFCR Index	-7,1%	-15,5%	-13,5%	28,4%	13,6%	13,2%
Benchmark	SXXR Index	-4,3%	-14,2%	-12,5%	38,3%	14,5%	14,2%

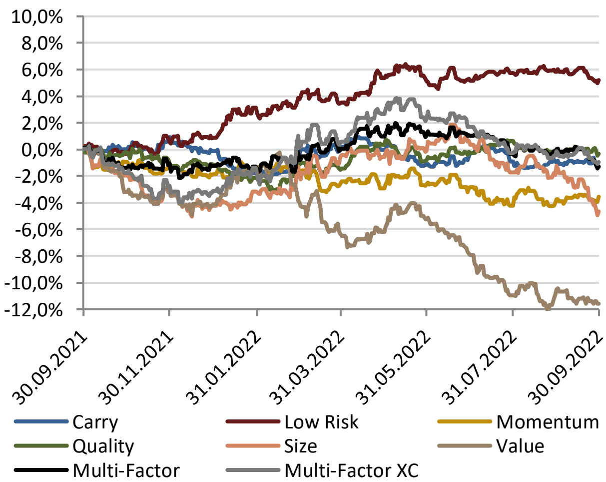
Excess Return 3 Months



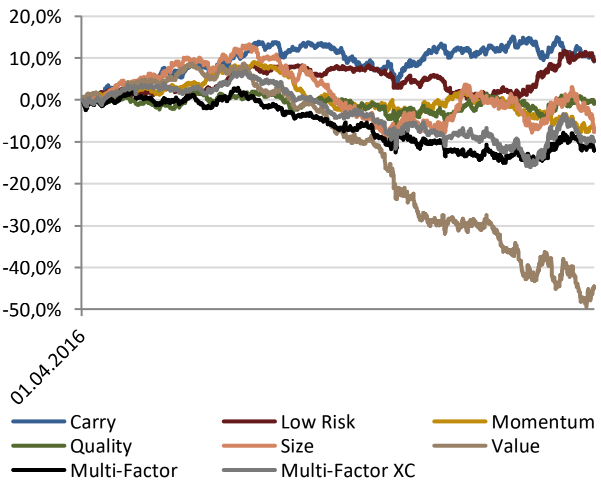
Excess Return 6 Months



Excess Return 12 Months



Excess Return since going Live (1.4.2016)



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