Is 2021 the start of a long-overdue resurgence in value performance?

*Featuring: **Hitendra D Varsani**, Executive Director, MSCI Research, **Bob Hum**, US Head of Factor ETFs at BlackRock*

Jenna Dagenhart:

Global economies are gradually reopening following the rollout of vaccines, reigniting discussion on the performance of value. After a prolonged period of relatively weak performance, value indexes outperformed across markets in late 2020 and continue to perform strongly in the first quarter of 2021.

Jenna Dagenhart:

Joining us today to talk about the resurgence of value and what economic indicators show for the road ahead, we have Bob Hum, US Head of Factor ETFs at BlackRock, and Hitendra Varsani, Executive Director, Core Research at MSCI.

Jenna Dagenhart:

Hitendra, starting with you, value has had a challenging run over the past 15 years, underperforming relative to the broader equity market. How has the value factor historically behaved in macroeconomic conditions, and what role does cyclicality play in the factor's performance?

Hitendra Varsani:

Sure. So, in our research series, we've investigated patterns of value, and also the other factors going back to the 1970s, and there's a few aspects that really stand out from this analysis. So, first is just to recognize that factors do go through periods of cyclicality, and that can last several years. And investors can see that both as an opportunity or as a risk.

Hitendra Varsani:

Now, clearly the 15 years of under-performance of value has puzzled many academics as well as practitioners, but let's quickly recap some of the characteristics of value from our research findings. There's four things that stand out. The first is that value typically outperforms during periods of market recovery and early-stage expansion. Secondly, value has seen out performance during periods of rising interest rates and increased expectations for inflation. Thirdly, the valuation spread matters as well. So how discounted are factors compared to other factors. And value has gone through a period where that discount is extreme levels and so potentially providing some tailwind for value going forward. And then fourth and finally, there tends to be persistence in factor performance. So those factors that have worked typically continue to perform in the short term.

Hitendra Varsani:

But what have we seen in the last six months? Post US elections, vaccine rollout, stimulus plans, reopening of businesses. We've actually seen all four of these points materialize, and that's been reflected in the out performance of value compared to the broader market and other factors by a considerable margin. And we've seen investor positioning move in along similar lines. ETF flows suggest investors are moving with conviction. Value in flows exceed growth, and they also exceed the flows relative to other factor ETFs as well.

Hitendra Varsani:

Now I'll be interested to see whether those investors on the sidelines believe this is simply a dead cat bounce, or there could be a structural shift in leadership going forward.

Jenna Dagenhart:

Building on that insight, Bob, could you share your views on what's been happening? What makes this time period different and what drivers are currently impacting economic recovery?

Bob Hum:

Yeah, absolutely. And to Hitendra's point, I think the number one question I'm getting from financial advisors is this a dead cat bounce or is this actually a structural change in the environment today? And what I say it's too early to tell, but I think what makes this time different isn't because just that value is cheap, right? Value can be cheap for a long time. And I think the old adage is that the markets can be irrational longer than you stay solvent. So, you need a catalyst behind why this change might be different, and I think the big one, and Hitendra touched on it, is the reopening of the economy. Right? So, think about 2020 last year. COVID really changed everything that we do. I know personally, I have a one-year-old, and so the three things that I do is basically I play with that one-year-old, we buy him diapers from Amazon, and I'm on Zoom calls pretty much every day.

Bob Hum:

You look at the stocks that did really well last year. It were those work from home type securities. Zoom was up 395%. Amazon was up 76%. These types of securities really shined in a period where the economies were closed. But what has happened today and what is happening really since the November, when the Pfizer vaccine news came out, is that there's light at the end of the tunnel. There's the potential for a reopening of the economy. And what is the number one thing that people want to do when the economy reopens? It's travel. It's going to hotels. It's flying. It's getting in your car. And you're seeing these stocks that were most beaten up during 2020 are actually starting to rebound. And I think that's been the biggest driver of that value out performance. About a 30% return difference between value and growth since November 9th. I think again, the big reason why was that news from Pfizer?

Bob Hum:

And so for us, we do think that vaccine news is a big catalyst for a potential shift in leadership. And so, client portfolios should be reflecting those potential changes in the marketplace today.

Jenna Dagenhart:

Let's shift now to some of the trends that you're seeing in sectors through a factors lens. What patterns have you observed?

Hitendra Varsani:

With the backdrop of increasing expectations for higher rates, higher inflation, coupled with economic recovery, so reflation, we're seeing a search for not just value, but also value in sectors as well. And those cyclical sectors, like financials, industrials, alongside energy had underperformed just a year ago. But since November, since the vaccine roll-out, these sectors that have been depressed have bounced back much more quickly.

Hitendra Varsani:

And I think an interesting observation is a distinction between what we think about value in stocks and value in sectors. So yes, we've seen technology, a growth orientated sector, pull back, and energy outperform, but from a stock selection point of view using valuation metrics, values work everywhere. So, it's not just in financials and energy, but stock selection, even in technology, the growth-oriented sectors, using value metrics has outperformed. And indexes like the MSCR enhanced value index are constructed sector neutral. So that's a diversified way of getting exposure to that value theme across the various sectors.

Jenna Dagenhart:

Finally, Bob, what are some of the key takeaways for investors and what should they consider as they're rebalancing their portfolios to adapt to the current market conditions?

Bob Hum:

Yeah. So, the number one thing that we're talking with financial advisors is understand the exposure within your portfolio. So, we've done about 20,000 portfolio engagements with financial advisors, analyzed 20,000 portfolios, and 62% of them actually are underweight value today. And oftentimes those advisors actually think they're overweight value. So, it could be a drift with a manager. It could be how they're putting the portfolio together.

Bob Hum:

So for us, I think the really important thing is teaching advisors to understand what those exposures are in the portfolio and is it reflecting their views on the market? Because I think today, I think a lot of advisors understand that there is a change in market sentiment, and they want to reflect that within their portfolios. Again, I think understanding what those exposures are is really critical, and tools that we have here at BlackRock and at MSCI can help understand what those exposures are, because I think one of the biggest risks in client portfolios today is that potential underweight to value.

Bob Hum:

So even though we've seen a 30% return difference between value and growth since November 9th, there's still about 100% return difference between value and growth over the last few years, right? This has been the worst drawdown in history for value. So, there's still a lot of potential room to run. And so, I think trying to close that underweight to at least a neutral, I think is pretty important for client portfolios today.

Jenna Dagenhart:

Well, Bob, Hitendra, thank you for joining us to share insight into value's recent resurgence and how investors can use factors to reposition their portfolios for an economic reopening.

Hitendra Varsani:
It's been great to be here.

Bob Hum:
Thanks for having us.

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