

Factor focus:

Value

In the realm of investing, a factor is any characteristic that helps explain the long-term risk and return performance of an asset. MSCI Factor Indexes are designed to capture the return of factors which have historically demonstrated excess market returns over the long run.

MSCI Factor Indexes are rules-based, transparent indexes targeting stocks with favorable factor characteristics – as backed by robust academic findings and empirical results – and are designed for simple implementation, replicability, and use for both traditional indexed and active mandates.

Defining Value

The foundation of value investing is the notion that cheaply priced stocks outperform pricier stocks in the long term. Value is categorized as a “pro-cyclical” factor, meaning it has tended to benefit during periods of economic expansion (see “Performance and Implementation”).

Value has several dimensions: the stock price as a multiple of company earnings, price as a

multiple of dividends paid, price as a multiple of book value, and other such “ratio descriptors.” Academics and investors differ on which best represents a value company, creating opportunity in the marketplace for a variety of investment products.

The MSCI Enhanced Value Index applies three valuation ratio descriptors on a sector relative basis:

- Forward price to earnings (Fwd P/E);
- Enterprise value/operating cash flows (EV/CFO); and
- Price to book value (P/B).¹

The index aims to address the pitfalls of value investing, among them “value traps” – stocks that appear cheap but which in fact do not appreciate. Our analysis shows that using forward earnings has helped provide protection against

value traps, and that whole-firm valuation measures, such as enterprise value, have reduced concentration in highly leveraged companies, meaning those that have borrowed heavily.

Why investors have used value strategies

Many investors use this approach in identifying assets that they expect the market to revalue.

The concept of value was first popularized in the 1930s by economists Benjamin Graham and David Dodd, who advocated owning companies that provide a “margin of safety” – meaning the current stock price is less than it is expected to be under conservative projections of the firm’s future earnings.²

Performance & --- implementation

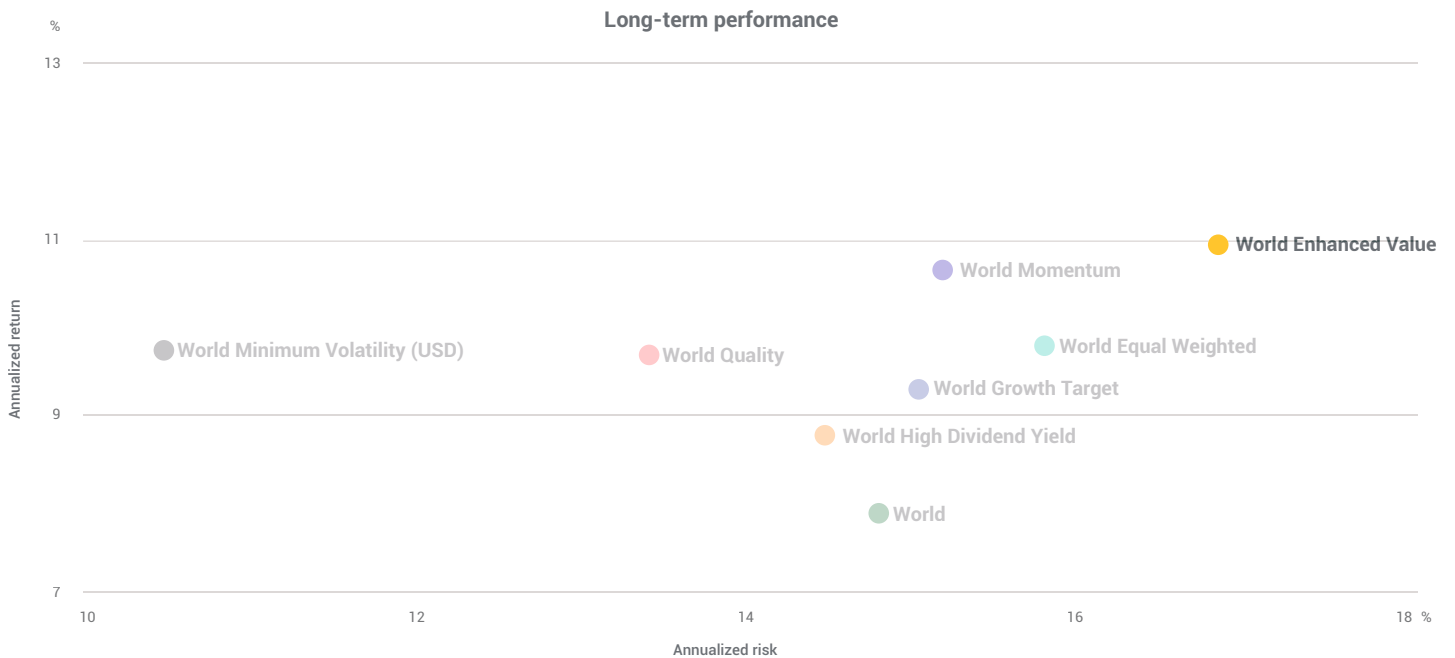
MSCI World Factor Indexes

Over time, individual factors have delivered outperformance relative to the market.



The MSCI World Enhanced Value Index has historically generated excess returns over the long run with a 3.1% annual return over the MSCI World Index since 1999 as represented above.

Long-term performance: May 1999 – December 2019



Although factor strategies have exhibited long-term outperformance, in the short-term, factor performance has been cyclical and has generated periods of underperformance.

At the core of value investing is the belief that “cheaply” valued assets tend to outperform “richly” valued assets over a long horizon.

How factors have performed relative to each other:

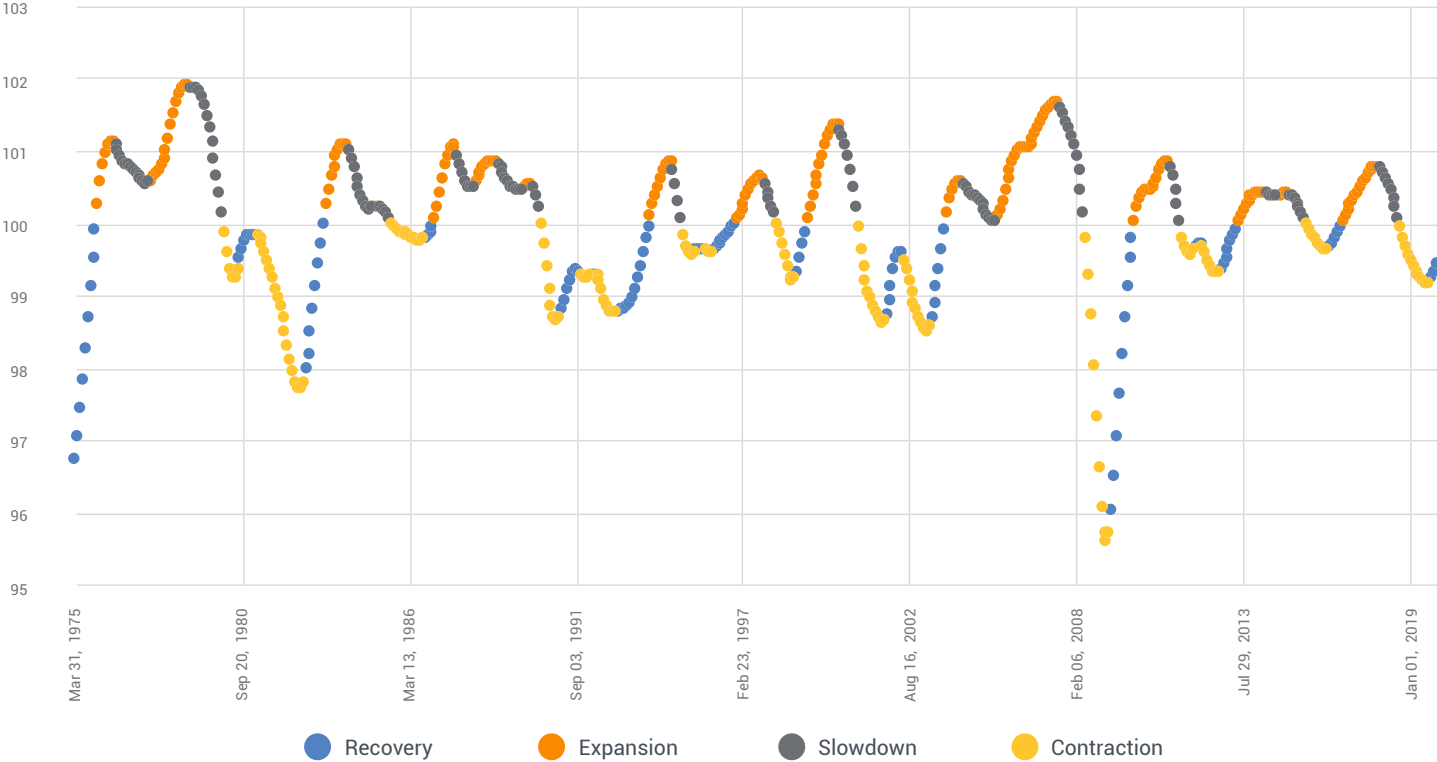
Value

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1.5%	-4.5%	-9.6%	56.7%	28.6%	28.4%	31.0%	19.9%	-29.2%	42.0%	18.2%	8.0%	16.7%	32.7%	12.1%	5.8%	10.3%	32.6%	-1.4%	36.7%
1.2%	-8.0%	-9.8%	50.4%	24.1%	17.2%	28.9%	16.8%	-33.5%	41.9%	9.1%	4.8%	16.5%	30.7%	9.0%	4.5%	9.4%	26.6%	-2.4%	28.4%
0.3%	-10.0%	-13.6%	40.1%	21.3%	15.2%	22.1%	11.4%	-37.8%	33.8%	7.2%	4.8%	15.0%	30.3%	7.0%	4.2%	8.9%	26.6%	-5.1%	28.3%
-2.1%	-11.5%	-14.4%	33.8%	20.8%	12.5%	21.8%	10.3%	-39.9%	33.5%	11.4%	4.4%	14.8%	27.7%	5.5%	1.2%	8.9%	23.9%	-6.7%	27.4%
-10.2%	-12.1%	-15.1%	30.5%	20.0%	10.0%	21.2%	9.6%	-40.3%	31.9%	9.3%	-5.0%	14.7%	27.4%	4.6%	-0.3%	8.2%	23.1%	-8.2%	24.5%
-12.5%	-16.5%	-16.5%	26.0%	19.3%	8.5%	20.7%	7.3%	-41.9%	30.8%	12.3%	-5.4%	13.7%	26.5%	4.6%	-1.0%	8.2%	22.9%	-8.5%	24.3%
-12.9%	-19.4%	-19.4%	25.9%	15.2%	8.3%	19.1%	6.4%	-42.4%	17.2%	12.8%	-9.3%	13.3%	22.9%	3.4%	-2.4%	5.1%	19.2%	-11.8%	24.0%
-18.9%	-20.5%	-19.5%	22.0%	12.7%	6.0%	16.8%	6.1%	-42.6%	14.8%	16.5%	-11.0%	8.9%	19.4%	3.3%	-2.7%	4.7%	18.0%	-13.4%	19.8%

- World
- World Enhanced Value
- World Quality
- World Equal Weighed
- World Minimum Volatility (USD)
- World Momentum
- World Growth Target
- World High Dividend Yield

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Macro effects on factor performance



In general, factor performance has been cyclical in nature. Individual factors have been shown to outperform during different macroeconomic environments.

Conclusion _____

Value investing is premised on identifying stocks whose prices seem to understate their intrinsic value. While many institutional investors may agree with that premise, implementation of value-index strategies differs widely. MSCI Enhanced Value Indexes are based on research that has found that combining value ratio descriptors has captured the value factor better than using any individual ratio descriptor alone.

Footnotes _____

1. Exceptions are Financials: Forward P/E and P/B, Real Estate: EV/CFO
2. Graham, B., D. Dodd, S. Cottle, R. Murray and F. Block. (1989). Graham and Dodd's Security Analysis, McGraw-Hill.



Learn more about Factor Investing at
www.msci.com/factor-investing

About MSCI Inc.

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