

WHY QUALITY STRATEGIES ARE DRIFTING TO VALUE VALUATIONS

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An interesting dynamic is developing in the [factor](#) world.

First, [momentum](#) strategies have gained a lot of media attention. They had garnered a reputation for being growth strategies, since growth was working for so long. Recently, [value](#) has taken over.

Twitter has caught on to the declining [price-to-earnings \(P/E\) ratio](#) of the [MSCI World Momentum Index](#) as evidence.

For instance:



Michael Venuto

@michael_venuto

...

It looks like a lot of value stocks have moved into the momentum index. [#stocks](#) [#markets](#) [#economy](#) [#investing](#) [#financialservices](#)



6:05 AM · Jun 13, 2021 · Hootsuite Inc.

Source: https://twitter.com/michael_venuto/status/1404062272323035138?s=20

Another interesting dynamic taking hold is that [quality](#) strategies—which select growth and quality companies—are showing [valuations](#) that rival traditional value indexes but with a different composition and sector mix.

One chart that explains some of what is going on is the divergent returns among strong-versus-weak balance sheet

stocks, exemplified by this Daily Shot graphic depicting returns based on balance sheet sorts of the market.

Strong [balance sheet](#) stocks are associated with higher-quality companies, and weak balance sheet companies are associated with low-quality stocks—and this big return dispersion—30 percentage point differential returns over the last six months or so—are leading to valuation discrepancies in these baskets.



Source: The Wall Street Journal Daily Shot Newsletter, 6/10/21.

While traditional value strategies select companies that earn lower returns on capital (measured by [return on equity \(ROE\)](#)) or even [return on assets \(ROA\)](#), the [WisdomTree Quality Dividend Growth Fund \(DGRW\)](#) is showing valuation multiples as compelling as the value benchmarks but with a process that focuses on high return on capital and strong balance sheet stocks.

DGRW has even lower forward P/E multiples than either the [Russell 1000 Value Index](#) or the [S&P 500 Value Index](#), despite having an ROE upgrade and improvement relative to the S&P 500.

Characteristic	DGRW	Russell 1000 Value	S&P 500 Value	S&P 500
Dividend Yield	2.12%	1.86%	2.03%	1.36%
Net Buyback Yield	1.06%	0.31%	0.46%	0.79%
Gross Buyback Yield	1.28%	1.13%	1.12%	1.25%
Shareholder Yield	3.18%	2.16%	2.48%	2.16%
Price/Earnings (P/E)	22.06	27.52	27.43	30.95
Price/Earnings (P/E) Excl. Negative	21.92	21.38	21.62	27.02
Percent Negative Earn	0.52%	10.00%	9.65%	5.18%
Estimated Price/Earnings (P/E)	17.61	18.63	18.32	22.16
Estimated Price/Earnings (P/E) Excl. Neg.	17.61	17.67	17.41	21.54
Return on Assets (ROA%)	7.44%	1.90%	1.89%	3.03%
Return on Equity (ROE%)	26.63%	9.87%	10.31%	14.48%
Return on Sales %	18.30%	12.18%	11.39%	13.90%

Sources: WisdomTree, FactSet, Russell, S&P, 5/31/21. You cannot invest directly in an index. Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Click [here](#) to view the 30-Day SEC yield and standardized performance.

For definitions of terms in the table, please visit the [glossary](#).

The sector compositions of the baskets that drive these valuations are also different.

While the S&P 500 Value and Russell 1000 Value are weighted highest in Financials—10% over-weight relative to the S&P 500—DGRW has half that Financials exposure, at under 6%.

Instead, DGRW has over-weight allocations to Health Care, meaningfully more weight in Information Technology stocks than value strategies, as well as over-weight allocations to Consumer Staples stocks.

Sector	DGRW	Russell 1000 Value	S&P 500 Value	S&P 500
Financials	5.64%	21.63%	21.43%	11.92%
Health Care	19.14%	12.52%	14.32%	12.97%
Industrials	17.01%	13.87%	11.97%	8.94%
Information Technology	25.09%	8.96%	11.17%	26.23%
Consumer Staples	16.33%	6.96%	8.89%	6.02%
Consumer Discretionary	4.70%	7.80%	7.63%	12.10%
Communication Services	6.45%	8.89%	6.49%	11.10%
Energy	0.41%	5.08%	5.64%	2.79%
Utilities	1.20%	4.81%	4.74%	2.56%
Real Estate	0.47%	4.47%	4.05%	2.55%
Materials	3.56%	5.00%	3.66%	2.82%

Sources: WisdomTree, FactSet, Russell, S&P, 5/31/21. You cannot invest directly in an index. Weights subject to change.

While in international markets this quality often results in a large-cap growth designation, in the U.S., DGRW is currently mapping in the value bucket as it did for much of 2020 as well.

Morningstar Style Map



The below chart shows how DGRW has historically been in the “US Fund Large Blend” category over the past five years, but over the last two years its style—which can deviate from year-to-year without triggering a category change—has been in Large Value.

Historical Style Map



Whether Morningstar will reclassify DGRW as a value strategy in time remains to be seen.

Value’s outperformance is being led by Financials and Energy and increasingly recent momentum strategy purchases. But if you believe this outperformance is apt to run out of steam, there is a way to get what we view to be compelling value-like valuations with an investment process that favors high-quality, [dividend](#) growth-oriented firms that are being neglected on a valuation basis today.

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There are risks associated with investing, including the possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund’s prospectus for specific details regarding the Fund’s risk profile.

There are risks of investing in value stocks such as the potential that a particular stock may not rise to its anticipated intrinsic value and could decline further in value.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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You cannot invest directly in an index.

DEFINITIONS

Momentum : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA) : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

Russell 1000 Value Index : A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Style : Morningstar defines its style box along two axes—large, mid-cap and small, as well as value, blend and growth. If two strategies are in the same style box, it does not mean that they hold the exact same portfolios, but it means that it might be harder to generate significantly different returns, as compared to strategies in different style boxes.

Dividend : A portion of corporate profits paid out to shareholders.