SEARCHING FOR VALUE IN 2023? LOOK AT SHARE BUYBACKS!

Christopher Gannatti – Global Head of Research
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As we position for 2023, which of these styles is going to lead–growth or value? Major growth-to-value rotations, like we saw in 2022, can often be the harbinger of a multi-year trend.

Below I drill into what is meant by "value" or "growth" and what different definitions of the terms mean. But one factor leads to a quite polarizing bifurcation of performance regarding net share issuance:

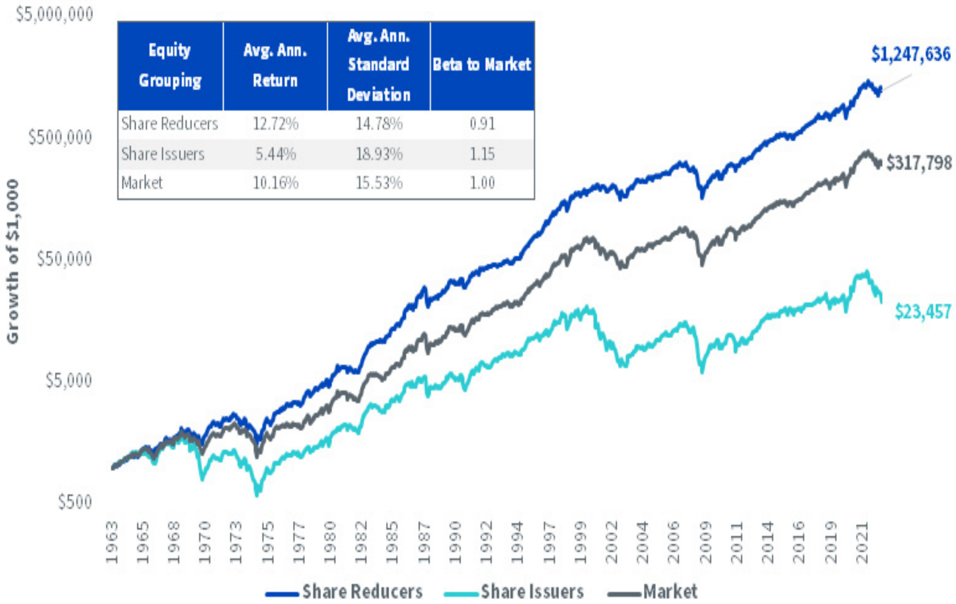
- Certain companies tend to increase their number of shares outstanding over time. Usually, shares are issued because a company needs to raise more capital or is doing a lot of share-based compensation.
- Certain companies tend to decrease the number of shares outstanding over time. These companies have excess capital they deploy into buying shares. A company cannot sustain this over longer periods if they are not profitable, even if there are ways to undertake this over the shorter term by issuing debt.

This simple distinction between a Share Issuer[1] and a Share Reducer[2] has been a rather powerful indicator of return potential.

In figure 1a, we examine the difference in returns over a very long period. Looking under the hood:

- The Share Reducers outperformed the Share Issuers by more than 700 basis points PER YEAR, going back to a starting point on June 30, 1963. While we doubt the typical investor is thinking in 60-year increments, this emphasizes that there is something very different going on in these two groups of companies.
- The Share Reducers achieved their performance with a lower measure of risk on this basis than the overall Market[3]. The beta, another measure of risk against the market benchmark, was 0.91 for Share Reducers.
    - A beta below 1.00 and a standard deviation below that of the market could mean it is a bit easier to stick with the strategy, mitigating the wide swings in more volatile approaches.

Figure 1a: Cumulative Difference in Returns



Source: https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/det_port_form_NI.html. Share Reducers, Share Issuers and the Market were previously defined in this piece. The historical returns illustrated in figure 1a represent an illustration of the performance of stocks with certain attributes and not the performance of any specific indexes. Past performance does not guarantee future results.

We Also Love to Harken back to History…

With the start of 2023, we've also been hearing a bit about history:

- **Will the 2020s look like the 1970s?** People ask this question because inflation was high in the 1970s, and inflation was the big narrative in 2022.
  - The Share Reducers returned 10.2% per year in the 1970s, whereas the Share Issuers returned 1.6% per year.
- **Will the 2020s look like the 2000s?** People look at the run-up in speculative "stay at home" tech stocks in 2020 after a period of ultra-low interest rates and outperformance of the growth style.
  - The Share Reducers returned 2.7% per year during the 2000s, delivering a positive return during a period where the market was actually down on a 10-year basis.

Figure 1b: Share Reducers vs. Share Issuers by the Decades against the Market

	1960s	1970s	1980s	1990s	2000s	2010s	Full Period
Share Reducers	10.0%	10.2%	21.6%	18.7%	2.7%	14.3%	12.7%
Share Issuers	5.9%	1.6%	12.9%	13.5%	-6.5%	9.8%	5.4%
Market	8.6%	6.1%	16.8%	17.9%	-0.4%	13.5%	10.2%
Reducers - Issuers	4.1%	8.6%	8.8%	5.2%	9.3%	4.4%	7.3%

Source: https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/det_port_form_NI.html. 1960s refers to June 30, 1963, to December 31, 1969. 1970s refers to December 31, 1969, to December 31, 1979. Each subsequent decade follows the same construct, meaning December 31, XXX9, to December 31, 10 years into the future. The "Full Period" represents all available history, which is from June 30, 1963, to December 31, 2022. Share Reducers, Share Issuers and the Market have been previously defined in this piece. The historical returns illustrated in figure 1b represent an illustration of the performance of stocks with certain attributes and not the performance of any specific indexes. Past performance does not guarantee future results.

WisdomTree's Take on Share Buybacks as a Means to Find a "Value"-Oriented Strategy

Since December 18, 2017, the [WisdomTree U.S. Value Fund (WTV)](#) has been undertaking an investment process to focus on companies emblematic of the "value" style.

Of course, the next question has to be—what is value?

There are a variety of definitions, from the simpler "book-to-market value" ratio to the more complex approaches that include multiple different fundamental ratios. There is not necessarily a single fundamental that works perfectly to define value across every type of company and business model.

WTV focuses primarily on "total shareholder yield," combining the dividend yield and the net buyback ratio. A high total shareholder yield indicates the company is returning strong amounts of capital to shareholders compared to its market price.

The Value Index Discussion Has Gotten a Bit "Spicy" of Late…

S&P undertook its regular rebalance process in December 2022. Part of the criteria between its growth-oriented and value-oriented benchmark indexes factored in momentum.

- Historically, stronger, positive momentum tended toward the growth side of the spectrum.
- Weaker, negative momentum tended toward the value side of the spectrum.

This all makes sense until we look at the sector dispersion in returns observed in 2022.[4]

The best-performing sector was Energy! Energy is a classic "value" sector, and even today, it sports among the lower valuation metrics of any sector. However, due to its strong, positive momentum, Energy saw its weight increase in growth benchmarks, which meant it necessarily had to decrease in the value benchmark from the S&P classification system.

The worst-performing sector in 2022 was Information Technology. That led to weight being added to this sector within the S&P Value Index series—and it was taken away from the exposure of the Growth Index. One of the results of that we see clearly in figure 2 (hence the "spice" in the discussion):

- Microsoft is now the top holding in the S&P 500 Value Index. Amazon.com is the third-biggest position. Meta Platforms is in position 5. While it didn't crack the top 10, Netflix was the 14th-largest position in the S&P 500 Value Index.
- WTV, with its focus on value, agrees with the classification on Meta Platforms—it was the number 1 holding. Meta was widely in the news throughout 2022, as CEO Mark Zuckerberg clearly stated his intentions for the metaverse and the spending to achieve his goals. While the company churned out cash, markets focused on all of the metaverse spending—and dubious initial results—alongside the general negative sentiment around the Facebook side of the platform. The market seemed to forget the company's advertising revenues, which, though potentially not growing, were also not dwindling away to zero and remained very, very large. 2022 was a very interesting time, in our opinion, to think about an allocation to this veritable "cash flow machine."
- Microsoft, Amazon.com, Cisco Systems—while these other Technology-oriented companies were not "perfect" and did have their share of issues in 2022, none were picked up as exemplifying "value" by virtue of WTV's process. We believe the bar should be high to prove a "value" orientation, and weak momentum on a 12-month basis would not get us there alone for any stock.

Figure 2: A Spicy Comparison of Top 10 Positions

WTV-Top 10 Holdings	
Company Name	Weight
Meta Platforms Inc. Class A	1.35%
Zillow Group, Inc. Class C	1.20%
Avis Budget Group, Inc.	1.20%
Builders FirstSource, Inc.	1.14%
Voya Financial, Inc.	1.11%
Dow, Inc.	1.07%
Marathon Petroleum Corporation	1.05%
United States Steel Corporation	1.05%
Fidelity National Financial, Inc. - FNF Group	1.05%
First American Financial Corporation	1.04%
Total	11.25%

S&P 500 Index-Top 10 Holdings	
Company Name	Weight
Apple Inc.	6.69%
Microsoft Corporation	5.78%
Amazon.com, Inc.	2.59%
Alphabet Inc. Class A	1.67%
Tesla Inc	1.66%
NVIDIA Corporation	1.63%
Berkshire Hathaway Inc. Class B	1.61%
Alphabet Inc. Class C	1.48%
Exxon Mobil Corporation	1.38%
UnitedHealth Group Incorporated	1.32%
Total	25.81%

S&P 500 Value Index-Top 10 Holdings	
Company Name	Weight
Microsoft Corporation	5.07%
Berkshire Hathaway Inc. Class B	3.35%
Amazon.com, Inc.	2.91%
JPMorgan Chase & Co.	2.54%
Meta Platforms Inc. Class A	2.39%
Bank of America Corp	1.49%
Walmart Inc.	1.24%
Walt Disney Company	1.20%
Cisco Systems, Inc.	1.20%
Wells Fargo & Company	1.10%
Total	22.49%

Source: FactSet, as of 2/25/23. Holdings are subject to change.

Click here for a full list of Fund holdings.

From Opinion to Black & White Facts

As to the bottom line of different Index methodologies, we'd recommend looking at figure 3, which showcases an array of valuation indicators.

- **WTV's dividend yield:** in line with that of the S&P 500 and S&P 500 Value Indexes. No major differences here.
- WTV's net buyback yield was in a completely different ballpark—9.1%. The figure for the S&P 500 and S&P 500 Value Indexes was only 2.4% and 2.3%, respectively.
- Since shareholder yield is defined as the sum of dividend yield and net buyback yield, the next page of the story is very clear. WTV had a double-digit value of 10.9%. Both the S&P 500 and S&P 500 Value Indexes were below 5.0%.
- Many people like to see a "single-digit" price-to-earnings (P/E) ratio. WTV delivered this—9.0x. The S&P 500 Index was 20.0x, and the S&P 500 Value Index was 20.0x. Read that again—the S&P 500 and S&P 500 Value Indices had the same P/E ratio. The "value" discount in the S&P 500 Value Index is therefore hard to discern on P/E ratios.
- WTV also delivered a much lower price-to-sales ratio—below 1.0x—while the S&P 500 Value Index was 1.7x and the S&P 500 Index was 2.2x.
- A classic approach to value—one that has a P/E ratio less than half that of the other benchmark indexes—should be vulnerable with respect to quality and profitability ratios. Usually, the market pays up with higher multiples on faster-growing, higher-quality companies.
  - Two stats to look at on a quality basis are return on equity (ROE) and return on assets (ROA). This is where WTV stands out from other value approaches: delivering an ROE of 25.8%, while the S&P 500 Index was only 18.4%. The S&P 500 Value Index was well behind—12.6%. ROA showed a similar pattern, with WTV, the S&P 500 and S&P 500 Value Indexes showing 4.7%, 4.1% and 2.4%, respectively.

So, in figure 3, we see an approach tilting further along the value spectrum into less-expensive stocks AND also maintaining a stronger focus on some critical quality metrics.

This is all by design, with WTV's process including a multifactor scoring system that selects good value on shareholder yield as well as high-quality stocks on these types of profitability ratios. Our thought was simple—it's possible to find value without sacrificing quality.

Figure 3: Value & Quality Characteristics

Characteristics	WTV	S&P 500	S&P 500 Value
Valuation			
Dividend Yield	1.8%	1.7%	2.0%
SEC 30-Day Yield	1.7%	N/A	N/A
Net Buyback Yield	9.1%	2.4%	2.3%
Shareholder Yield	10.9%	4.0%	4.3%
Price-to-Earnings	9.0x	20.0x	20.0x
Price-to-Book	2.4x	3.9x	2.6x
Price-to-Sales	0.8x	2.2x	1.7x
Return on Equity	25.8%	18.4%	12.6%
Return on Assets	4.7%	4.1%	2.4%

Source: FactSet, as of 3/9/23. The performance data quoted represents past performance and is no guarantee of future results. Investment return 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. Current performance may be lower or higher than the performance data quoted.

For the most recent month-end performance and SEC Standardized click here.

For definitions of terms in the table above please visit the glossary.

Bottom Line: Maybe Those Following the S&P 500 Value Index Need a New Approach

While we know it's a bold statement to challenge an S&P 500 Index variant within U.S. equities, we feel that in 2023 it needs to be done. To us, if people really believe in a value rotation and that something other than Tech will lead markets in the coming years, then there is a risk that the S&P 500 Value Index may have rebalanced itself out of being able to capitalize on value stocks winning.

WTV's approach, on the other hand, seeks to manage valuation risk no matter what the market throws its way, as its investment process is designed to evolve with the times.

[1] Share Issuers: Sourced from the Kenneth French Data Library, taken from the universe of all U.S.-listed companies as those that are in the top 20% when ranked on the basis of share issuance and would represent some of the biggest "share issuers" over time. The universe is screened annually in June.

[2] Share Reducers: Sourced from the Kenneth French Data Library, taken from the universe of all U.S.-listed companies as those where there would be a reduction in the shares outstanding over the annual period, measured in June of each year.

[3] Within the context of figure 1a, the Market is represented by all publicly listed U.S. equities, weighted on the basis of their market capitalizations.

[4] The following discussion of sectors is based on the S&P 500 Index universe, so when we say "Energy," for example, we mean the stocks within the S&P 500 Index universe that are classified within the Energy sector.

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For the top 10 holdings of WTV please visit the Fund's fund detail page at https://www.wisdomtree.com/investments/etfs/equity/wtv

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You cannot invest directly in an index.

DEFINITIONS

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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 tim.

Basis point : 1/100th of 1 percent.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Standard deviation : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Book-to-Market Value Ratios : a ratio used to find the value of a company by comparing the book value of a firm to its market valu.

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.

Shareholder Yield : A data point that references the combination of dividend yield and buyback yield.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Buyback ratio : The ratio of the amount of a company's buybacks to its market capitalization.

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.

S&P 500 Value Index : A market capitalization-weighted benchmark designed to measure the value segment of the S&P 500 Index.

Net Buyback Yield : A company's net share buyback is the difference between the capital raised by issuing new shares and the money the company spent on buying back any outstanding shares. A positive net share buyback means that more was spent on buying back existing shares than received from issuing new shares. Net buyback yield is the amount of a company's net buybacks divided by its market capitalization. Please note that net buyback yield does not represent a dividend paid by the company.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

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.

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.

Multi-Factor Model : A financial model that employs multiple factors in its calculations to explain market phenomena and/or equilibrium asset prices.