

Value, Growth or neither?

Published 16 February 2023

Pierre Debru

Head of Research, WisdomTree Europe.

Looking at equity markets as a conflict between Value stocks and Growth stocks has become a reflex for many market commentators. 'Growth is beating Value' (or the other way around) is always a good headline. Value stocks are defined as basically cheap stocks and it is, therefore, possible in any index, to point to the Value side of that index. Growth stocks are defined as stocks with above-average growth prospects. So again, it is possible to look at an index and point to the growthiest stocks. The main index providers have done exactly that by splitting their main indices in two down the middle, a Growth and a Value version, as early as the 1980s.

Using Value and Growth to explain the last ten years

While simplistic and playing into human's love of false dichotomies, it is true that this narrative explained the last ten years of equity performance pretty well. From the overwhelming domination of Growth stocks, in a negative interest rate environment where investment was cheap, to the start of a Value revival last year, on the back of the most aggressive tightening cycle in decades.

Figure 1: Relative performance of Growth vs Value in the last ten years

Source: WisdomTree, Bloomberg. From 31 January 2013 to 31 January 2023. Growth is proxied by the MSCI World Growth net TR Index. Value is proxied by the MSCI World Value net TR Index.

You cannot invest directly in an index.

Historical performance is not an indication of future performance and any investment may go down in value.

What about the other factors? Didn't Quality perform better over that period?

However, most things in our world can't be reduced to a simple choice. Academics have demonstrated over the last five decades that multiple other factors can be used to slice and dice the markets to create outperforming portfolios. In the 90s, Fama and French introduced their 3-factors model using Value but also Size and Momentum to explain market returns. More recently, they added Profitability (often called Quality) and Investment in a new 5-factors model.

Looking at the performance of the seven leading factors over the last ten years, we note that while Growth beat the market by 1.6% per annum and Value underperformed by 1.9% per annum, the strongest factor was, in fact, Quality with an outperformance of 2.3% per annum¹.

Is Quality Value or Growth, then?

Using Quality as a third lens, we observe that companies in the Value index are, on average, less profitable than those in the benchmark, and that those in the Growth index are, on average, more so. 23% of the S&P 500 Value exhibit less than 10% in return on equity (ROE) versus less than 5% for the S&P 500 Growth. And 25% of the S&P 500 Growth has more than 50% in ROE versus less than 5% for the Value index.

Figure 2: S&P Value and S&P Growth holdings split by return on equity

Source: WisdomTree, Bloomberg. 31 January 2023. Return on equity reflects the consensus estimate for return on equity (that is, the mean of sell-side analyst estimates).

You cannot invest directly in an index.

Historical performance is not an indication of future performance and any investment may go down in value.

However, what is fascinating is that in the Value index, there are still some very profitable companies and in the Growth index, there are still some unprofitable companies. In other words, the Value/Growth dichotomy is very different from the High Quality/Low Quality one. The market could therefore be split not into two indices (Value and Growth) but into four:

- High-Quality Value
- High-Quality Growth
- Low-Quality Value
- Low-Quality Growth

Historically, High-Quality Value has outperformed High-Quality Growth

Using academic data, it is possible to splice US equity markets since the 60s into groups by fundamental data. In Figure 3, we focus every year on the 20% of the universe with the highest operating profitability (that is, High Quality in Figure 3). That group is then split into five further quintiles depending on their valuations (using price to book (P/B) as a metric) from the cheapest to the most expensive.

In Figure 3, we observe that picking profitable companies with high P/B would have outperformed the market since the 60s but would have underperformed profitable companies in general. On the contrary, picking cheaper High-Quality companies would have outperformed both the market and the overall High-Quality grouping. In other words, Quality Value has outperformed Quality Growth over the last 60 years in US equity markets. Looking at other geographies, such as Europe, we find similar results.

Figure 3: Annualised returns of High-Quality portfolios of US stocks based on their valuations since the 1960s

Source: Kenneth French data library. Data is calculated at a monthly frequency and from July 1963 to December 2022. 'High Quality' representing the top 20% by operating profitability. The portfolios are rebalanced yearly at the end of June. The market represents the portfolio of all available publicly listed stocks in the US. All returns are in USD. Operating profitability for year t is annual revenues minus cost of

goods sold, interest expense, and selling, general, and administrative expenses divided by book equity for the last fiscal year end in t-1.

You cannot invest in an index.

Historical performance is not an indication of future performance and any investments may go down in value.

At WisdomTree, we believe that a well-constructed Quality strategy can be the cornerstone of an equity portfolio (see [Looking back at equity factors in Q4 with WisdomTree](#) and [When inflation is high investors focus on high pricing power equities](#)). High-Quality companies exhibit an ‘all-weather’ behaviour that offers a balance between building wealth over the long term whilst protecting the portfolio during economic downturns. However, in 2022, secondary tilts were incredibly important. Value stocks benefitted from central banks’ hawkishness, leaning on their low implied duration to deliver outstanding performance in a particularly hard year for equities. Among Quality-focused strategies, the one with Value tilt delivered outperformance on average, and the one with Growth tilt tended to underperform.

Looking forward to 2023, recession risk continues to hang over the market like the sword of Damocles. While inflation has shown signs of easing, we expect central banks to remain hawkish around the globe as inflation is still very meaningfully above targets. The recent coordinated communication plan by Federal Reserve Federal Open Market Committee members is a further example of this continued hawkishness. With markets facing many of the same issues in 2023 that they faced in the second half of 2022, it looks like resilient investments that tilt to Quality and Value that have done particularly well in 2022 could continue to benefit.

1 Source: WisdomTree, Bloomberg. From 31 January 2013 to 31 January 2023. Growth is proxied by the MSCI World Growth net TR Index. Value is proxied by the MSCI World Value net TR Index. Quality is proxied by MSCI World Quality net TR Index. The remaining 4 factors (Min Vol, High Dividend Small Cap and Momentum) are also proxied by indices in the MSCI families.

Related blogs

- + [Looking back at equity factors in Q4 with WisdomTree](#)
- + [When inflation is high, investors focus on high pricing power equities](#)
- + [What's Hot: Endgame for central banks far from done](#)

Important Risks Related to this Article

IMPORTANT INFORMATION

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.

An investment in exchange-traded products (“ETPs”) is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this

document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

Issuer Disclaimer The products discussed in this document are issued by WisdomTree Issuer ICAV ("WT Issuer"). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland ("CBI"). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities ("UCITS") under the laws of Ireland and shall issue a separate class of shares ("Shares") representing each fund. Investors should read the prospectus of WT Issuer ("WT Prospectus") before investing and should refer to the section of the WT Prospectus entitled »Risk Factors¼ for further details of risks associated with an investment in the Shares.

Notice to Investors in Switzerland – Qualified Investors This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree¼s website: **https://www.wisdomtree.eu/fr-ch/resource-library/prospectus-and-regulatory-reports**

Some of the sub-funds referred to in this document may not have not been registered with the Swiss Financial Market Supervisory Authority ("FINMA"). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

For Investors in France: The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares

in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.