Has Value's Run Just Begun?

Part 2: A Long and Winding Path

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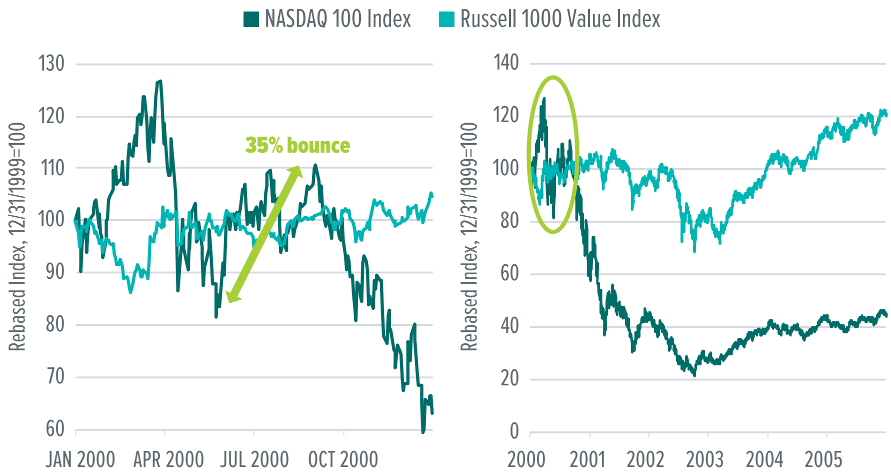
Snapshot

- To gain perspective about what has been the strongest equity-market rotation toward value leadership in decades, we compared the current environment with the 1995-to-2000 tech bubble.
- Both periods exemplify the tendency of capital markets to reverse course when they've reached extreme valuations (which growth stocks have). Historically, these reversals have been followed by a move back toward long-term-average conditions.
- We believe that investors who hastily cash in on value's early gains face a good chance of missing out on the potential for significantly greater returns should value stocks continue to ascend.

From the beginning of 1995 to March 2000, just about any company with a ".com" suffix in its name enjoyed rising stock prices in a charging bull market. The Nasdaq Composite Index, home to most internet companies, rose by approximately 570% in cumulative terms as growth stocks (some of which had no hope of ever generating any earnings) trounced their value counterparts. Legendary value investor Warren Buffett famously avoided tech stocks at the time and faced criticism that he was out of touch for sticking to the traditional value approach, which is based on fundamental analysis designed to find quality companies selling at attractive prices[1].

Buffett and other investors with a value orientation were proven right when investors realized that many of the companies were trading at stock prices that were unlikely to ever be justified by earnings (a situation stock traders often refer to as a "bubble") and prices crashed. That relief appeared to be short-lived (as shown in Exhibit 1). Just over three months later, a 35% bounce in the NASDAQ 100 Index from the initial selloff once again provided a boost to tech shares and reason to doubt the fundamental case for value shares. Yet, we know with the benefit of hindsight that value ultimately prevailed in the ensuing years. Unfortunately, that knowledge is little consolation for investors who gave up on value shares when tech stocks temporarily rebounded. The lesson here: trends are long term in nature but short-term reversals are not uncommon.

Exhibit 1: A Reminder from the Dot-Com Era—It's Not All Smooth Sailing When Trends Change



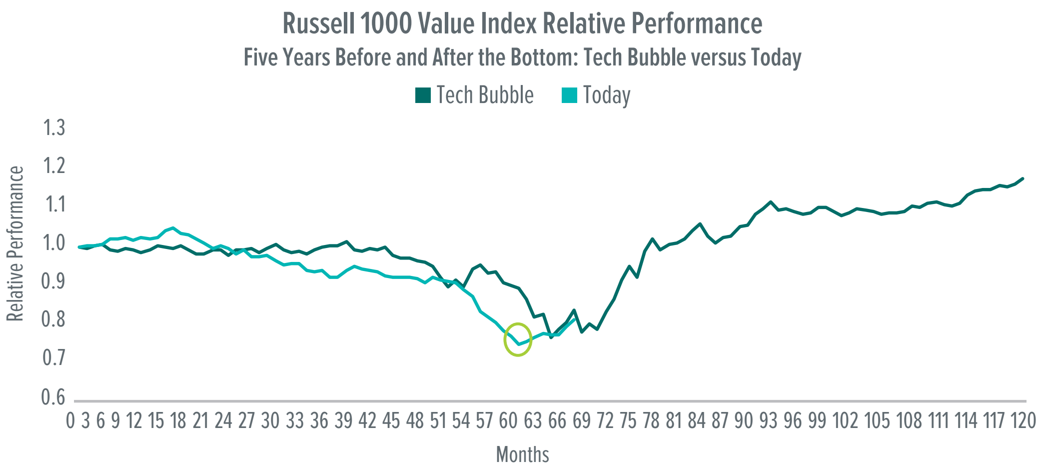
Source: SEI, FactSet. U.S. equities represented by Russell 1000 Value Index. Data for the period from 12/31/1999-12/31/2005. Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

[1] See Berkshire Hathaway annual shareholder letters circa 1999 and 2000.

Recent market events have started to follow a similar pattern to those of 20 years ago, with both featuring a short period of great performance by value stocks following a deeply challenging period. These are case studies in mean reversion—the tendency of capital markets to reverse course when they've reached extremes and move back toward long-term-average conditions. Again, these trends don't move in a straight line. Like those investors who rejected value during the tech bubble days, we believe investors who are currently rushing to decrease their value exposure—so soon after its rebound from extreme undervaluation—face higher odds of missing out on potentially greater returns as the asset class continues to ascend.

While we recognize there are significant differences between today and 20 years ago, we think the comparison between the current environment and the tech bubble provides useful context in understanding how a strong rotation to value leadership can play out. The path is often long and winding, but history shows that growth stocks will not lead the market forever (Exhibit 2).

Exhibit 2: Retracing the Tech Bubble of 1999—Still a Long Way to Go



Source: SEI based on Factset, MSCI and Russell. Relative performance based on difference in returns between Russell 1000 Index and Russell 1000 Value Index. The green-circled low point in the "Today" time series coincides with September 2020. Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

SEI's View

The comparison between current and past market reversals and, more importantly, the economic and fundamental underpinnings of value's leadership (which we addressed in ***Has Value's Run Just Begun? Part 1: The Economic and Fundamental Case***) underscore our reasons for believing in the durability of value's advance.

The next entry in this series—***Has Value's Run Just Begun? Part 3: Value Stocks—Still a Good Time to Buy?***—explores why the timing appears right for value from an opportunistic standpoint.

Glossary of Financial Terms

Bull market: A bull market refers to a market environment in which prices are generally rising (or are expected to do so) and investor confidence is high.

Growth stocks: Growth stocks exhibit steady price or earnings growth above that of the broader market.

Tech bubble: The tech bubble was a period during the late 1990s that coincided with the rapid growth and adoption of the internet. Speculation in the shares of internet-related companies resulted in a stock-market bubble that ultimately began to collapse in early 2000.

Index Definitions

Nasdaq 100 Index: The Nasdaq 100 Index is composed of the 100 largest, most actively traded U.S. companies listed on the Nasdaq stock exchange with the exception of financial-industry stocks.

Nasdaq Composite Index: The NASDAQ Composite Index is an unmanaged, market-capitalization weighted index that consists of all securities listed on the NASDAQ exchange. It is often used to gauge performance of global technology stocks.

Russell 1000 Index: The Russell 1000 Index includes 1,000 of the largest U.S. equity securities based on market cap and current index membership; it is used to measure the activity of the U.S. large-cap equity market.

Russell 1000 Value Index: The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

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