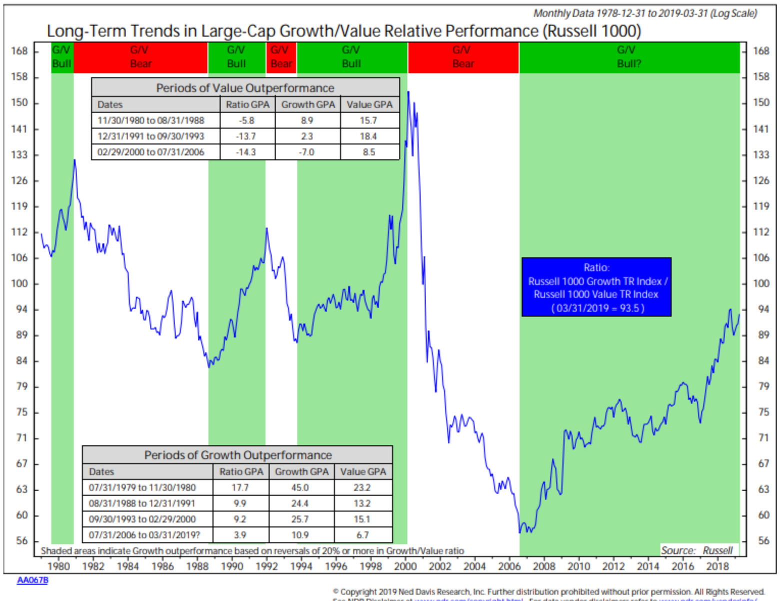
The Outperformance of Large Cap Relative Growth to Large Cap Value has been Historic

1978-2019



Source: Ned Davis Research

It's Final Four weekend in college basketball and our office favorite Virginia Cavaliers are competing for a national championship. One aspect that makes the event exciting is that of the four teams competing, the last team that won a national championship was Michigan State at the turn of the century. In the investing world, value investors have been waiting a similar length of time for their shot to get back in the spotlight.

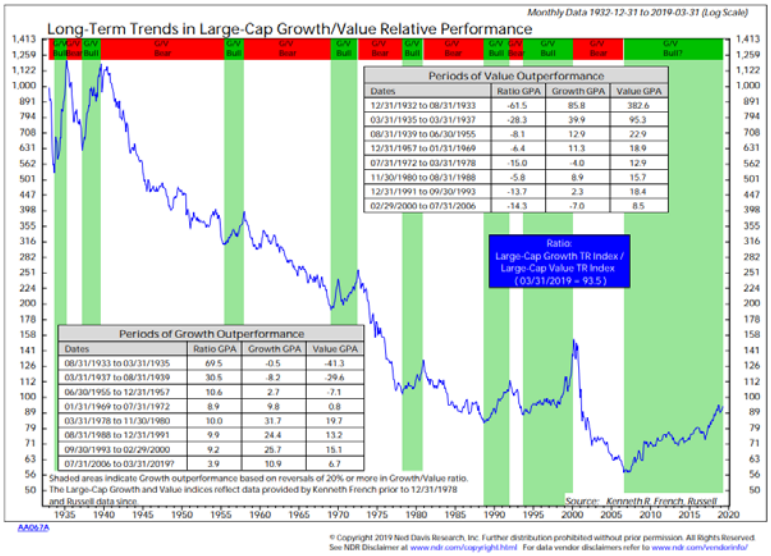
A consistent theme stemming from recent client meetings has been the performance disparity between growth stocks and value stocks. What has changed in this classic debate is that the run in growth stocks has been historic as seen in the chart above that depicts the relative performance of large cap domestic growth stocks versus value stocks (in blue). The green highlighted area shows that since 2007, or over a decade ago, growth stocks as defined by Russell Investments have outperformed value. Moreover, recently the growth index has outperformed by 5.6% annualized over the past four years. The performance differential is the highest since the late 1990's "New Economy" era. The current environment appears to be the result of a low growth economic environment coming out of the last recession where due to low interest rates imposed by the Federal Reserve, investors have focused on stocks with above average growth characteristics.

The performance disparity has led to a healthy discussion of value investing as famed Berkshire Hathaway vice chairman Charlie Munger was asked last year for his view. He responded to a Yahoo Finance interview, "Now there are various ways to look for value investments, just as there are various places to fish. And the first rule of fishing is to fish where the fish are…The first rule of value investing is to find some place to fish for value investments where there are a lot of them." The investment team at Sterling is on a constant pursuit for target rich areas for clients, and while the performance of growth versus value remains unabated, one factor that may put value back on the front page are relative valuations. The graphic below highlights that while valuation can be tricky in terms of timing turns, the valuation gap between growth and value stocks is approaching extended levels.

Source: J.P. Morgan Asset Management

Large Cap Growth/Value Relative Performance

1932- 2019



Source: *Ned Davis Research*

Is it different this time? Growth bulls point to historic outperformance of growth later in the economic cycle as an inverted yield curve can curb bank lending and financial stocks lag the market. It's also worth noting, however, that over the long haul, value has beaten growth and we have included a long term chart from the 1930's where growth has underperformed value on a longer term basis.

Just like recruiting a national championship team, we look for stocks with upside potential and in the market we are finding opportunities in the value space most notably in the Equity Opportunities' Equity Income strategy. Over the past six months (with the exception of the real estate investment trust we purchased that is not valued on earnings), the average stock has a price-to-earnings ratio on forward earnings of 11x, a meaningful discount to benchmark. The stocks, however, have a dividend yield higher than the benchmark and are growing faster at an average rate of 25%. These stocks appear to have a combination of growth and value that we find attractive as we endeavor to build winning portfolios for clients.

As always thank you for your interest and trust managing your investments.

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