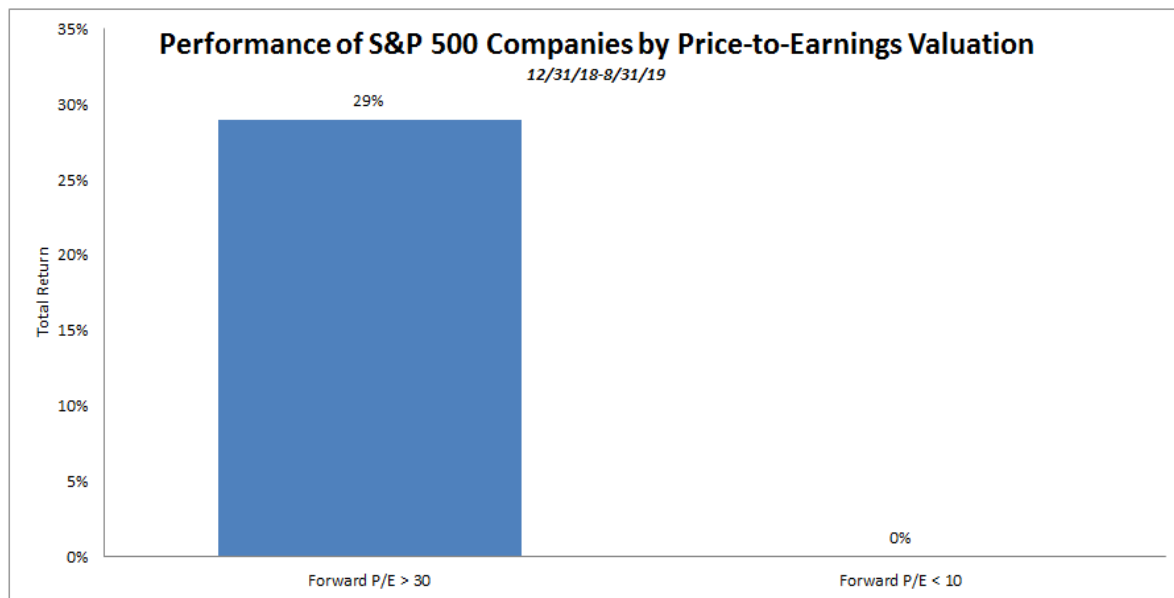




"The salvation of mankind depends upon independent thinkers directing their thoughts rightly."

-Ralph Waldo Emerson

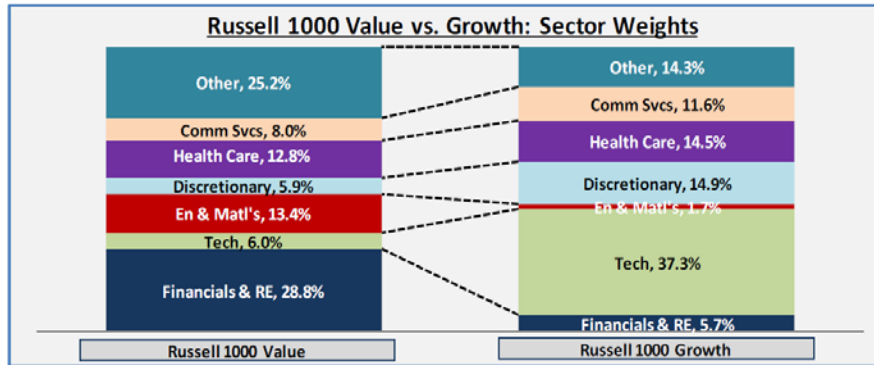


Source: Bloomberg

As investors, we are always looking for the next opportunity for our clients. Part of this search is sharing information within the research group on what's working in "the market" and what is not; and while we are bottom up investors, we also need to understand the investing backdrop. Perhaps the most common topic in 2019 has been the diversion in performance between growth stocks, value stocks, and potential reasons for the performance gap. Indeed, from the beginning of the year through the end of August, the Russell 1000 Growth Index has outperformed its value partner by close to 9% with a total return of 22.1% versus 13.2%. The performance gap has been more pronounced globally with the MSCI Growth Index up 16.1% versus only 2.4% for the MSCI Value where both indices include stocks outside the U.S. in developed markets.

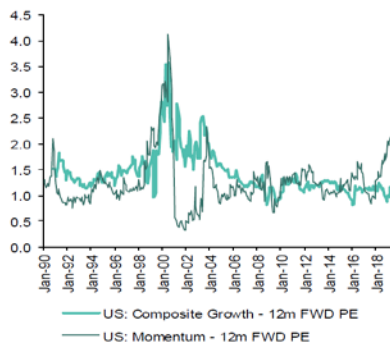
One interesting development, shared by our Charlotte team, highlighted how highly valued stocks have been outperforming. As seen in the chart above, the 72 stocks in the S&P 500 on the high end of valuation have materially outperformed the 91 companies with single-digit price-to earnings multiples.

However, you may be surprised that the largest sector represented in this group were REIT stocks, not considered an area of "high growth." Why have REIT stocks generated performance in line with growth stocks such as Adobe? Perhaps it is their bond like characteristics that have had the stocks act like bonds as interest rates in the U.S. have declined to historic lows, and prices have gone up. What is making growth stocks trading at more than 30x earnings attractive? Bernstein research notes that "it is very hard to fight the duration trade – lower discount rates mean that cash flows in the future are worth more now." Sustainable growth is where "the market" appears to be ascribing value. They note, "discounted cash flow models became popular in a world where discount rates were often in a range of 10%. If the discount rate (weighted cost of capital) falls from 10% to 5% in a very simple representative discounted cash flow model then **the value for the cash flows more than 5 years in the future rise from 70% to 95%.**" While a case can be made for growth stocks, higher priced slow growth momentum stocks may be stretched in terms of valuation (chart in left column on next page).



Source: Wolfe Research

EXHIBIT 4: Valuation of Momentum vs. Composite Growth US (12m fwd P/E)



Source: MSCI, Factset, Bernstein analysis

One other point is that “value” and “growth” are broad terms and are an amalgamation of stocks in various sectors. While we can debate the metrics used to define growth and value, the Wolfe Research chart above breaks down the sectors within each index. Not only do financials represent the largest sector in the Russell 1000 Value index, but, using the performance data from

the first page, bank stocks with price-to-earnings ratios below 10x are also the most common poor performers in 2019.

The momentum stocks of 2019 are not necessarily the unicorn initial public offerings or high beta cyclical stocks, but staid office REITs with steady cash flows. In discussing performance with clients, the move in global interest rates to historic lows can impact the performance of an individual stock and the index where it resides. By seeking to understand the investing backdrop, we look to use our perspectives to generate excess returns for clients.

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

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