Global Stocks: Is Value’s Outperformance Peaking?

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Notes from the Global Growth Equity Desk

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Key Takeaways

- Growth underperformance appears overextended given expectations that economic growth will slow and inflation risk will moderate.
- The extreme shift in momentum in favor of value and dividend yield factors has left investors underappreciating earnings growth and overpaying for defensiveness.
- We expect continued volatility and will be sticking with proven approaches and long-term strategies.

Investor sentiment remains gloomy. Ongoing supply chain disruptions, lockdowns in China, and war-related food and fuel shortages are weighing on businesses and investors alike. These issues have aggravated worries that persistently higher inflation and the Fed’s effort to contain it will trigger a recession or even stagflation.

The U.S. 10-year Treasury yield almost doubled from 1.6% at the end of 2021 to around 3% by the end of April 2022. Equity markets have sold off alongside rates and credit. The MSCI All Country World Index, a measure of global equity performance, is down 13% year-to-date as of 4/30/2022.

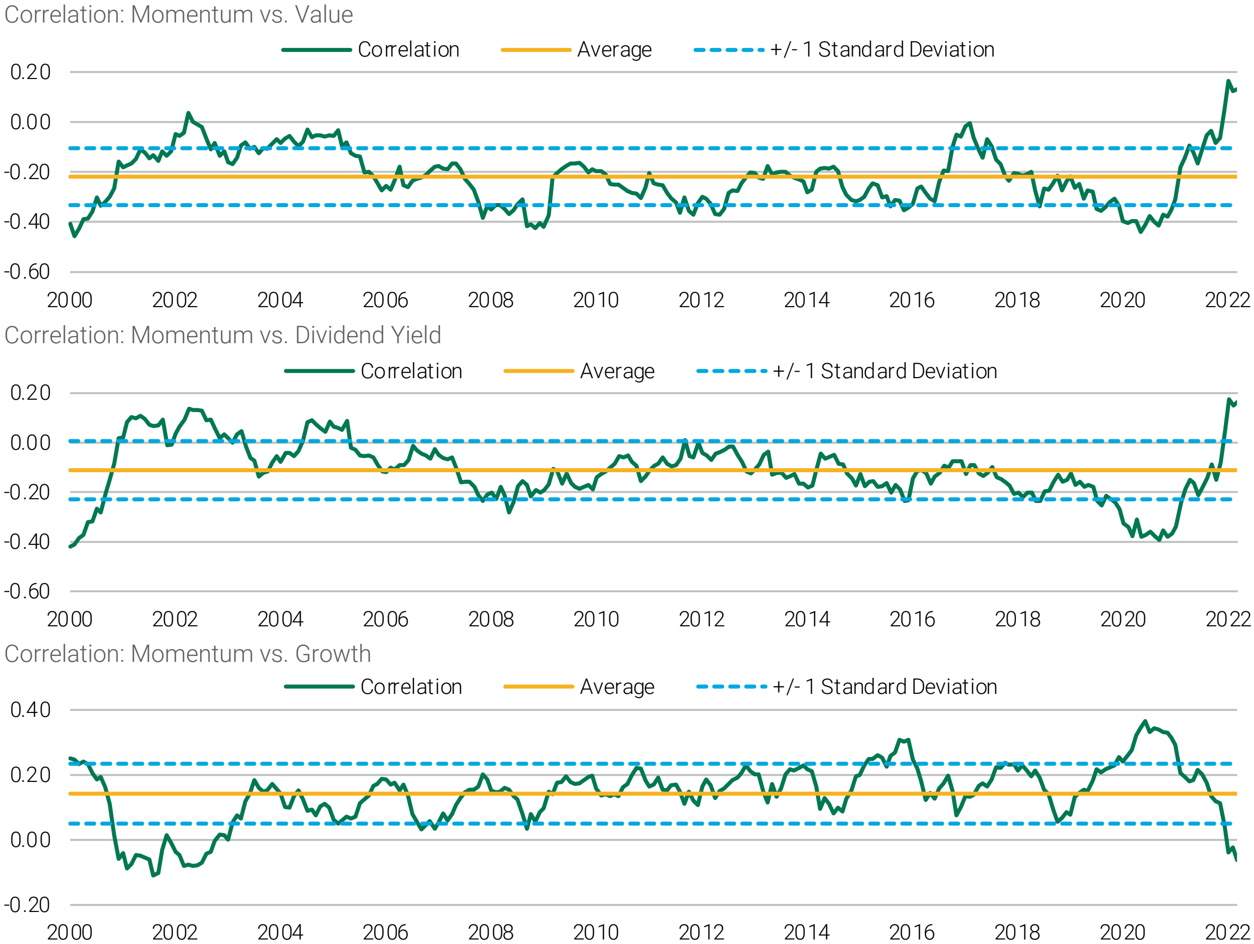
So far this year, only a handful of industries have delivered positive results — chiefly energy, mining and tobacco producers. They are heavily represented in value indices and help explain value’s recent outperformance.

Conversely, companies with growth profiles have been the worst hit. Traditional growth sectors, including consumer discretionary, media and information technology, have led the underperformers.

The Correlation of Momentum and Value Factors Are at 20-Year Highs

While the rotation into the more defensive categories may continue, we see indications the shift away from growth may be peaking. For example, Figure 1 shows how the correlation of value and dividend yield factors to momentum is at levels not seen since the tech crash in 2001. Meanwhile, the correlation of growth factors to momentum has headed the opposite direction.

Figure 1 | The Correlation of Value and Momentum Factors are at Multi-Decade Highs

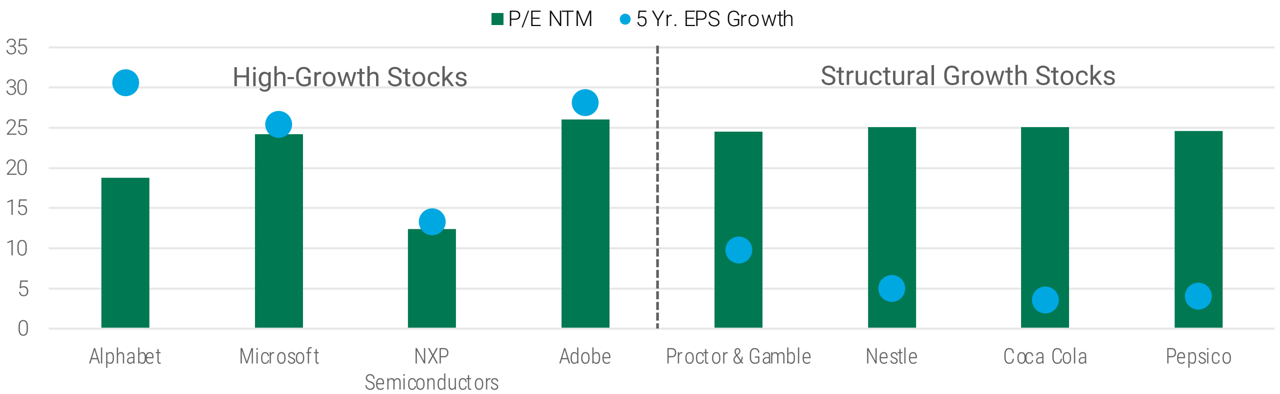


Data for all charts from 2/29/2000 – 4/29/2022. Source: MSCI, American Century Investments. Based on factor analysis of the MSCI ACWI Index.

Select Defensive Stocks Are Priced Like Fast Growers

The strong outperformance of perceived defensive businesses in the food and household goods categories has resulted in a rerating of those stocks. In some instances, low structural growers are trading at multiples comparable to those of faster-growing companies. See **Figure 2**.

Figure 2 | Notable Growth Stocks Trading at Similar Multiples With Slow Structural Drivers



Data as of 5/12/2022. Source: FactSet.

Inflationary Pressure May Be Peaking

The higher inflation and rising interest rates we've experienced tend to be less of a headwind for value stocks. Looking ahead, we expect economic growth to slow and inflationary pressures to stabilize. We think this will put a greater premium on companies that can sustain their earnings growth in this environment and create a more positive backdrop for growth stocks.

Still, the timing of when inflationary pressures might ease remains highly uncertain. The prices of copper and other commodities have already fallen from recent peaks, but pricing remains elevated in areas like travel (airlines, car rentals) and the labor market.

We believe there are early indications that inflationary pressures are starting to wane. For example, **Figure 3** shows how monthly U.S. CPI less food and energy appears to be past its peak levels.

Figure 3 | U.S. Inflation – Core CPI

Data from 1/31/2017 – 4/29/2022. Source: FactSet, U.S. Department of Labor, U.S. Bureau of Economic Analysis.

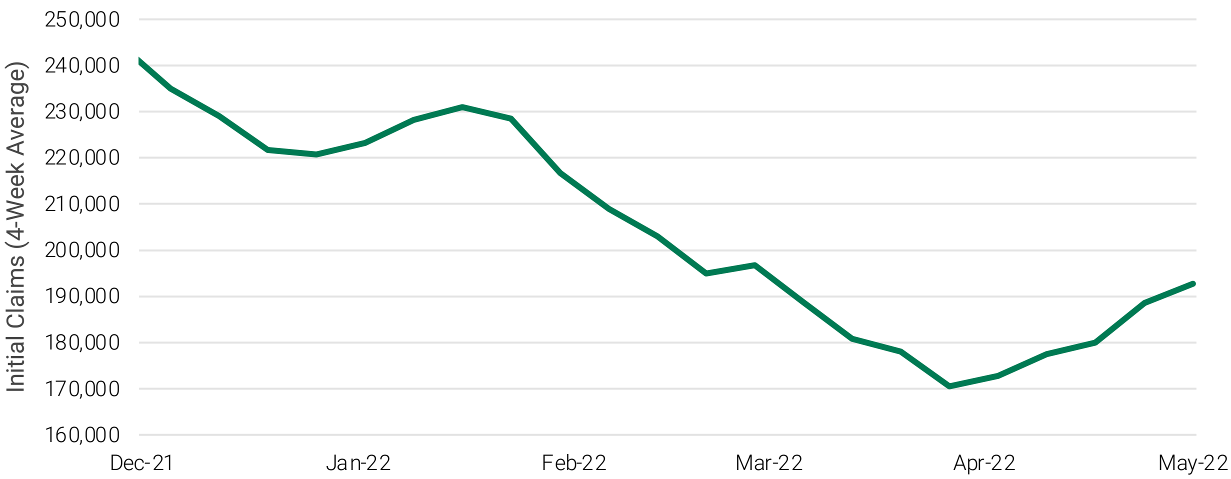
As **Figure 4** illustrates, U.S. 10-year breakeven rates, a market-implied future inflation rate derived from the price difference between Treasuries and TIPS, have also turned lower after rising through the majority of the first quarter.

Figure 4 | U.S. 10-Year Breakeven Inflation Rate

Data from 5/14/2021 – 5/13/2022. Source: FactSet.

In the labor markets, the availability of workers remains tight but the four-week average for unemployment claims has recently ticked up. Similarly, ADP reported that small business hiring has started to slow after strong hiring growth over the last few years. We've also seen some layoffs or hiring freezes announced at tech companies such as Carvana, Vroom and Twitter.

Figure 5 | U.S. Weekly Unemployment Claims



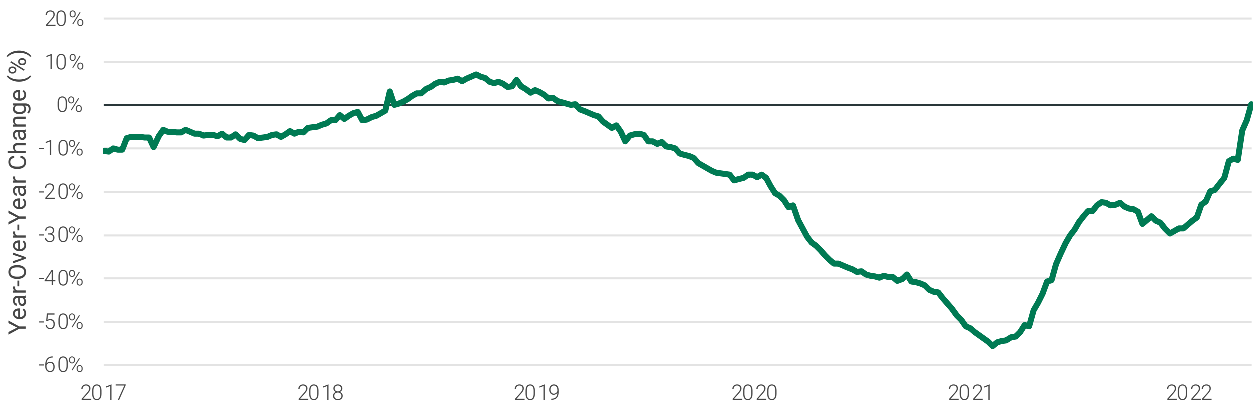
Data from 12/3/2021 – 5/6/2022. Source: FactSet.

Housing Market May Be Poised to Cool

Housing is the largest component of both the Personal Consumption Expenditures Price Index and Consumer Price Index. It's also been one of the hottest segments of the U.S. economy due to attractive mortgage rates and tight inventory. However, we think there are indications these tailwinds may be starting to ebb.

For example, mortgage rates have begun to rise, and we've seen evidence that tight housing inventories may be loosening. In absolute terms, the number of available houses remains low compared to historical trends. However, Figure 6 shows that the growth of active listings on a year-over-year basis has turned up compared to nearly three years of decline.

Figure 6 | Weekly Active Listings



Don't Overreact

As higher rates begin to bite and take inflation lower, we would expect the growth underperformance to plateau. We would caution, however, that timing factor performance and forecasting inflation are extremely difficult. In periods of market volatility, it is important not to overreact and stick with long-term investment strategies.

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