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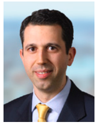
Pivoting From Innovation and Growth to Value

In this new world, valuations should begin to matter in a way they haven't for the last decade.

Insight from sub-adviser Wellington Management



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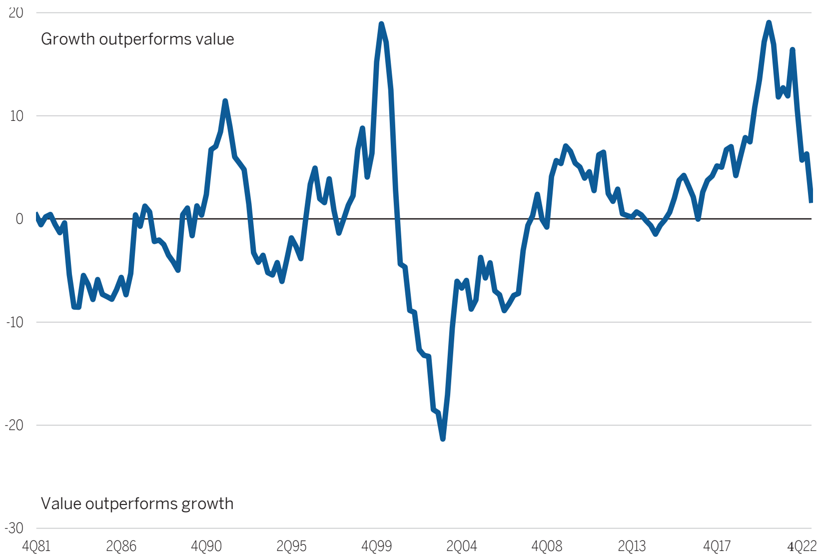
Are we transitioning from the post-Global Financial Crisis market regime to something new? What could that mean for asset allocators and portfolio positioning? While allocators can't assume they'll be able to spot the next regime's winners, they can be careful about their exposure to the prior winners and think broadly about which areas of the market are likely to offer more compelling returns over the next 5–10 years.

In terms of prior winners, growth stocks certainly stand out. We've been in a decade-long period in which growth dominated, aided by innovation and technologies that transformed the economy and fundamentals. But as I've said before, there is clear historical evidence of a growth/value cycle (**FIGURE 1**), and I expect to see value regain leadership eventually. We may also be moving into a more volatile world in which stability takes priority over innovation, which would tend to favor value.

FIGURE 1
Historically, the Cycle Always Turns
Rolling 3-year performance difference (annualized) of growth–value performance (%)



Past performance does not guarantee future results. Investors cannot invest directly in indices. Chart data: 4Q81–4Q22. Note: Return difference calculated using Russell 1000 Growth and Russell 1000 Value Indexes. See last page for index definitions. Sources: Refinitiv Datastream, Wellington Management

Key Points

- We may be moving into a more volatile investing world in which stability takes precedence over innovation.
- Value may look more attractive going forward because stocks with lower valuations could sell off less in some scenarios.
- Going forward, I believe stability will be scarce and stocks that can offer relative stability could outperform.

Portfolio Implications

Value — In this new world, valuations should begin to matter in a way they haven't during the last decade. Value could provide a margin of safety when we're in volatile markets, meaning that stocks with lower valuations could sell off less in some scenarios. In addition, the sector mix in the value universe, which tends to include areas such as energy, natural resources, and financials, may be more attractive in what I believe will be an inflationary regime.

Relative Stability — There's an adage that when growth is scarce, growth stocks outperform, and this was true for much of the last decade. Going forward, I believe stability will be scarce and stable stocks are likely to outperform. In terms of specific types of strategies that fall into a relative "stability" bucket, low-volatility strategies may have a place, but it's worth noting that they tend to be challenged in rising-rate environments. I would look to "compounders" (equity strategies focused on companies with high and stable free-cash-flow yield and the potential to grow modestly but steadily over time) and to defensive global-equity strategies that seek to preserve capital in adverse markets while providing equity-like returns in up markets.

Income — Equity income hasn't been an area of focus among allocators for some time, but that may change. The immediate cash flow may be more attractive in an inflationary world, but I also look to dividend growers as another source of calm in a storm: Companies that are able to grow their dividends over time may provide an element of quality and stability.

Growth — While we may be approaching a long-awaited pivot to value, investors in an uncertain world may be well advised to maintain a diversified factor footprint, and that includes exposure to growth. That said, allocators may need to consider a different kind of growth in the next decade—it might be steadier, self-financing, and less-speculative growth, for example. Or it might be growth driven by long-term thematic trends that will transform the way we live.

The sector mix in the value universe may be more attractive in what I believe will be an inflationary regime.

For more value investing ideas, please contact your financial professional.

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

Important Risks: Investing involves risk, including the possible loss of principal. • Different investment styles may go in and out of favor, which may cause underperformance vs. the broader stock market. • For dividend-paying stocks, dividends are not guaranteed and may decrease without notice. • Investments in the natural-resource industry may increase liquidity risk, volatility and risk of loss if adverse developments occur. • • Diversification does not ensure a profit or protect against a loss in a declining market.