

P E R S P E C T I V E

Are Value Stocks Cheap for a Fundamental Reason?

August 30, 2021

We have been discussing the attractiveness of the [value factor](#) for many months based on the unusually high value spread, which compares the valuation multiples of expensive stocks to cheap stocks. This metric is still extremely cheap... 90th + percentile cheap across all regions.

Value Spreads for Hypothetical Industry-and-Dollar-Neutral Value Portfolios*

January 1, 1984 – June 30, 2021



*Spreads are constructed using the Hypothetical Value portfolio as described below, and are adjusted to be dollar-neutral, but not necessarily beta-neutral through time.

Source: AQR. Hypothetical value composite includes four value measures: book-to-price, earnings-to-price, forecast earnings-to-price, and sales-to-enterprise value; spreads are measured based on ratios. To construct industry-neutrality, the value spreads are constructed by comparing the aforementioned value measures within each industry, which are then aggregated up to represent an entire portfolio. Hypothetical data has inherent limitations, some of which are disclosed in the Disclosures. Please see the Hypothetical U.S. Large Cap, International, and Emerging Valuation Theme Model Descriptions in the Disclosures. For illustrative purposes only and not representative of an actual portfolio AQR currently manages. Please read the Disclosures for important disclosures.

We think this signals an unusually attractive forward-looking return for the value factor, but some investors have wondered if value is cheap for a reason. Maybe the fundamental prospects for value stocks are unusually poor today, justifying the high value spread? This is by far the most popular question we get from skeptics. And, yes, we have an answer that doesn't require a four-hour time commitment nor a PhD (though finance PhDs may also be able to follow along). In a recent post, "[Are Value Stocks Cheap for a Fundamental Reason?](#)," we explain why we look at the value spread, and why the current high value spread is forecasting high expected returns, not lower than usual fundamental growth rates for cheap versus expensive stocks. And we cover all of this in five minutes. We encourage all investors, both skeptics and value geeks, to listen to this post, and we welcome any feedback.

Disclosures

This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer or any advice or recommendation to purchase any securities or other financial instruments and may not be construed as such. The factual information set forth herein has been obtained or derived from sources believed by the author and AQR Capital Management, LLC ("AQR") to be reliable but it is not necessarily all-inclusive and is not guaranteed as to its accuracy and is not to be regarded as a representation or warranty, express or implied, as to the information's accuracy or completeness, nor should the attached information serve as the basis of any investment decision. This document is intended exclusively for the use of the person to whom it has been delivered by AQR, and it is not to be reproduced or redistributed to any other person. The information set forth herein has been provided to you as secondary information and should not be the primary source for any investment or allocation decision. Past performance is not a guarantee of future performance.

This material is not research and should not be treated as research. This paper does not represent valuation judgments with respect to any financial instrument, issuer, security or sector that may be described or referenced herein and does not represent a formal or official view of AQR. The views expressed reflect the current views as of the date hereof and neither the author nor AQR undertakes to advise you of any changes in the views expressed herein.

The information contained herein is only as current as of the date indicated, and may be superseded by subsequent market events or for other reasons. Charts and graphs provided herein are for illustrative purposes only. The information in this presentation has been developed internally and/or obtained from sources believed to be reliable; however, neither AQR nor the author guarantees the accuracy, adequacy or completeness of such information. Nothing contained herein constitutes investment, legal, tax or other advice nor is it to be relied on in making an investment or other decision. There can be no assurance that an investment strategy will be successful. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such.

The information in this paper may contain projections or other forward-looking statements regarding future events, targets, forecasts or expectations regarding the strategies described herein, and is only current as of the date indicated. There is no assurance that such events or targets will be achieved, and may be significantly different from that shown here. The information in this document, including statements concerning financial market trends, is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons.

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH, BUT NOT ALL, ARE DESCRIBED HEREIN. NO REPRESENTATION IS BEING MADE THAT ANY FUND OR ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN HEREIN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY REALIZED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS THAT CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS, ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

The hypothetical performance results contained herein represent the application of the quantitative models as currently in effect on the date first written above and there can be no assurance that the models will remain the same in the future or that an application of the current models in the future will produce similar results because the relevant market and economic conditions that prevailed during the hypothetical performance period will not necessarily recur. Discounting factors may be applied to reduce suspected anomalies. This backtest's return, for this period, may vary depending on the date it is run.

Hypothetical performance results are presented for illustrative purposes only. In addition, our transaction cost assumptions utilized in backtests, where noted, are based on AQR Capital Management, LLC's, ("AQR") historical realized transaction costs and market data. Certain of the assumptions have been made for modeling purposes and are unlikely to be realized. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented. Actual advisory fees for products offering this strategy may vary.