FACTOR/STYLE INVESTING

Style Timing: Value vs. Growth

January 1, 2000

A large body of academic and industry research supports the efficacy of value strategies for choosing individual stocks. Value strategies are far from riskless, however. They can have long periods of poor performance.

Researchers have tried to improve on value strategies by incorporating various macroeconomic measures, including earnings yield on the S&P 500, the slope of the yield curve, corporate credit spreads and corporate profits. These “style timing” models have produced mixed results.

In this paper, we take a different approach. We have built a model that considers two simple factors: 1) the spread in valuation multiples between a value portfolio and a growth portfolio (the value spread), and 2) the spread in expected earnings growth between a growth portfolio and a value portfolio (the earnings growth spread). We find that the greater the value spread and the smaller the earnings growth spread, the better the forecast for value versus growth going forward. Our model currently forecasts near-historic highs in the expected one-year return of value stocks versus growth stocks. These results are statistically and economically strong.