

QUALITY VALUE ROTATION

Matt Wagner – Associate Director, Research
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What a dizzying turnaround for [value](#).

After a severe [drawdown](#) in early 2020, the long-anticipated reversal in favor for lower-multiple stocks finally took hold last fall.

For historical context, only the bursting of the tech [bubble](#) ushered in such a profitable cycle for value over trailing three-month and six-month time frames.

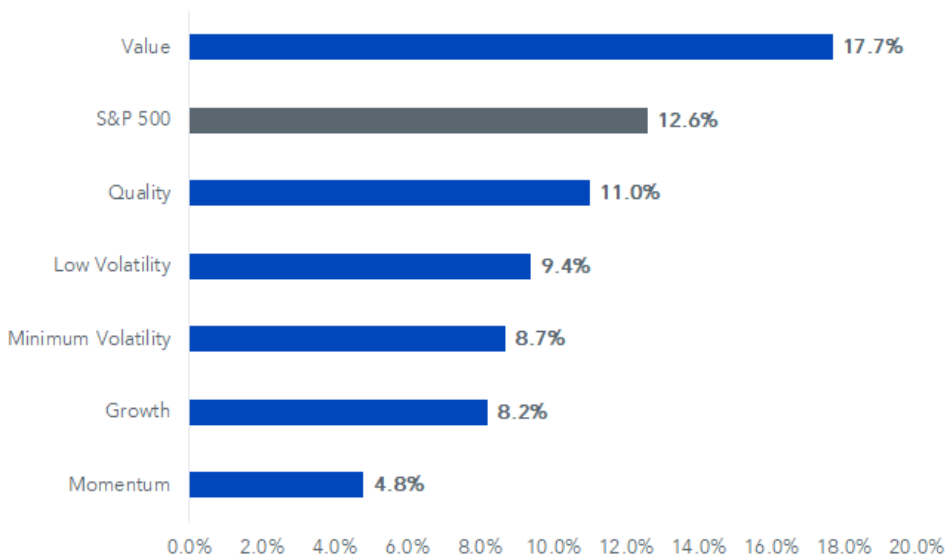
Top 10 Periods for Value: Value (High Book-to-Market) vs. [Growth](#) (Low Book-to-Market)

High Book-to-Market (Low P/B) vs. Low Book-to-Market (High P/B)		
Trailing 3-Months	Trailing 6-Months	Trailing 1-Year
21.86% - Dec-2000	36.78% - Dec-2000	56.13% - Jun-2001
17.85% - Mar-2021	35.34% - Mar-2001	46.21% - Mar-2001
16.39% - Dec-2016	35.33% - Mar-2021	35.87% - Sep-2001
15.43% - Mar-2001	28.76% - Sep-2009	32.23% - Dec-1958
15.43% - Sep-2008	21.71% - Jun-1992	30.47% - Dec-2000
14.44% - Mar-1992	21.07% - Mar-1976	27.79% - Mar-1959
14.18% - Mar-1976	20.00% - Dec-2016	26.72% - Dec-1976
14.04% - Sep-2000	19.01% - Jun-1993	26.54% - Sep-1993
13.52% - Sep-1974	18.64% - Jun-2001	26.23% - Sep-1976
13.25% - Mar-1993	17.10% - Jun-1981	26.19% - Jun-1959

Sources: WisdomTree, Kenneth French Data Library, 12/31/1957–3/31/2021. Returns using value-weighted Big Hi-BM vs. Big Lo-BM portfolios from Kenneth French Data Library. Table using quarterly observations. Past performance is not indicative of future returns.

The growth-versus-value story attracts the bulk of the attention. But for many [factor](#) investors, the question going forward is how long the underperformance of quality, [low volatility/min vol](#) and momentum will persist.

Year-to-Date Factor Returns

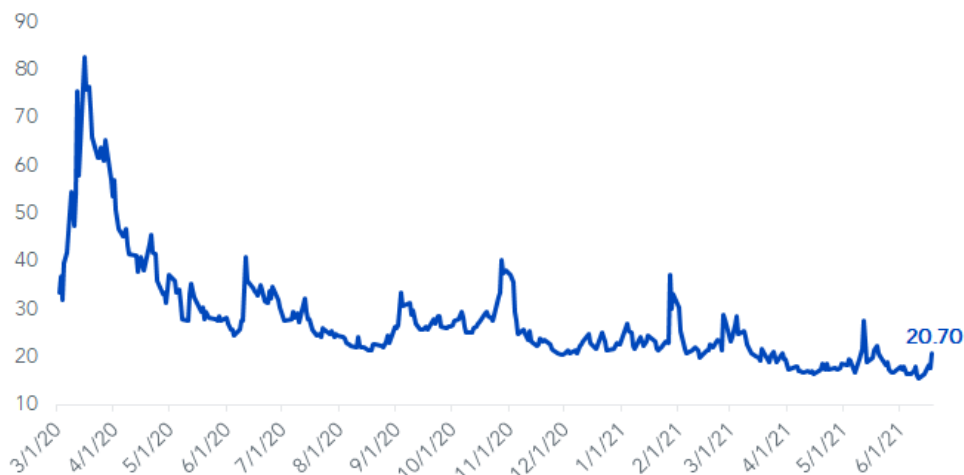


Sources: WisdomTree, S&P, 12/31/20–5/31/21. Factor indexes are respective S&P 500 factor indexes. You cannot invest directly in an index. Past performance is not indicative of future returns.

Improving economic conditions, rising [interest rates](#) and a significant decline in market [volatility](#) have all coalesced to buoy the riskiest, most depressed value shares. The [Cboe Volatility Index](#) recently touched a post-pandemic low of 15.65 on June 11.

Volatility modestly picked up following the conclusion of last week’s Federal Reserve meeting, and value has been giving way to growth for the past several weeks now. However, it is still too early to call whether that seems like a start of a trend.

Cboe Volatility Index (VIX) – 3/2/20–6/18/21



Sources: WisdomTree, FRED. You cannot invest directly in an index. Past performance is not indicative of future returns.

One narrative gathering attention—and that we recently discussed on our blog—is [the notion that there are two distinct types of value companies](#).

In the recent run-up in value, the most distressed/riskiest/[junkiest](#) names have been the strongest market leaders. In the next phase of the cycle, we believe quality value companies are more likely to lead as investors become more discerning about profitability and [balance sheets](#).

According to a recently published Citi Research report¹, this shift was seen in prior instances of value outperformance following the global financial crisis and the tech bubble. The change in leadership occurred approximately six months into value’s [bull](#) run. We are about six-to-nine months into the current cycle, depending on how you track

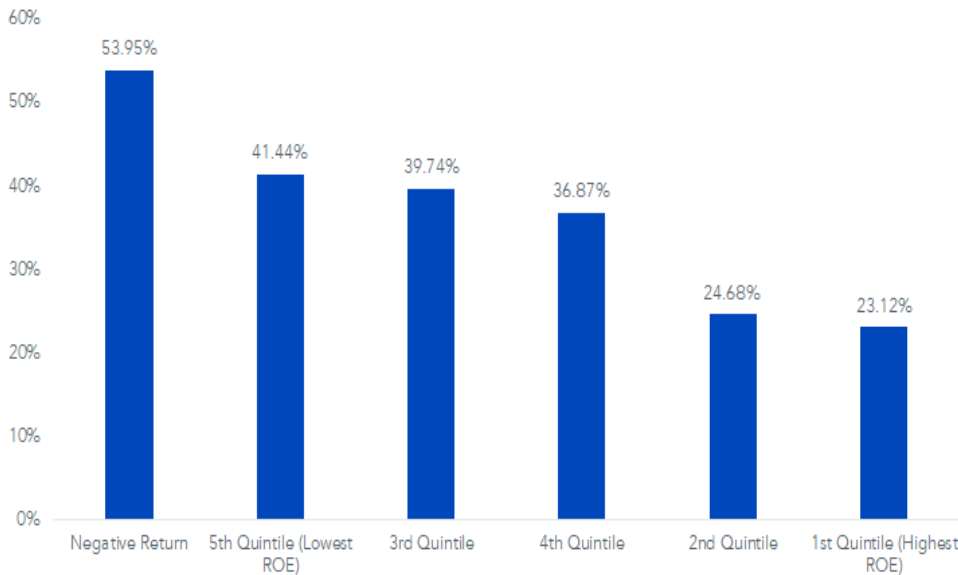
it.

Low Profitability Leading

There are still many factors in favor of value relative to growth, including historically attractive relative valuations and [mean reversion](#) after more than a decade of value underperformance.

With that in mind, we think investors should focus on higher-quality value names. Recent returns have favored companies with low (or no) profits—the distressed value names—but history suggests profitability is an important factor for long-run returns.

Russell 1000 Value Index: Return on Equity Quintile Returns (8/31/20–5/28/21)



Sources: WisdomTree, FactSet, Russell. You cannot invest directly in an index. Past performance is not indicative of future returns.

For example, the [WisdomTree U.S. LargeCap Dividend Index](#)—a value-tilted Index that selects and weights constituents based on dividends—has historically been over-weight in the most profitable quintile by over 18%. This over-weight allocation has contributed 121 basis points of annualized outperformance relative to the Russell 1000 value Index going back to June 2006.

VS.

As of:

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Category	Attribution Component				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
1st Quintile (Highest ROE)	0.80%	0.17%	0.24%	1.21%	27.94%	9.32%	18.62%	13.31%	12.81%
2nd Quintile	0.05%	0.14%	0.02%	0.21%	20.97%	17.32%	3.65%	10.65%	9.69%
3rd Quintile	-0.02%	-0.07%	0.03%	-0.06%	17.79%	21.43%	-3.64%	7.60%	7.84%
4th Quintile	0.04%	0.02%	-0.06%	0.00%	16.75%	24.63%	-7.88%	7.99%	7.84%
5th Quintile (Lowest ROE)	0.05%	-0.14%	-0.11%	-0.20%	12.06%	20.74%	-8.68%	5.40%	6.25%
Negative Return	0.02%	-0.22%	0.15%	-0.05%	1.59%	4.15%	-2.56%	-9.05%	-1.62%
N/A	0.09%	0.02%	-0.17%	-0.06%	2.90%	2.42%	0.49%	12.52%	12.99%
Total	1.03%	-0.09%	0.10%	1.04%	-	-	-	9.18%	8.14%

Sources: WisdomTree, FactSet, Russell, 5/31/06-5/31/21. N/A category includes primarily companies with negative equity but also those for which we do not have data. You cannot invest directly in an index. Past performance is not indicative of future returns.

In addition to having higher profitability than the Russell 1000 value Index, the WisdomTree U.S. LargeCap Dividend Index is at a [discount](#) on [forward price-to-earnings \(P/E\)](#) valuations.

Index Forward [P/E Ratios](#)



Sources: WisdomTree, FactSet, 6/30/06–5/31/21. You cannot invest directly in an index.

The Bottom Line: For investors who believe there's more room to run for value, but also that the junk rally is soon to run out of steam, consider a higher-quality value basket.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market outlook](#)

View the online version of this article [here](#).

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DEFINITIONS

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Bubble: when market participants drive stock prices above their “fair value” in relation to some system of stock valuation.

Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Factor: Attributes that based on its fundamentals or share price behavior, are associated with higher return.

Low volatility: Characterized by lower standard deviation of price over time. This term is also associated with the Low Volatility Factor, which associates lower volatility stocks with better risk-adjusted returns vs the market over time.

Minimum Volatility: Funds that use an optimization that will consider the correlation of companies to each other in order to get a lower volatility index overall.

Volatility: A measure of the dispersion of actual returns around a particular average level.

Junk Bond: A high-yield or non-investment grade bond. Junk bonds are fixed-income instruments that carry a rating of ‘BB’ or lower by Standard & Poor’s, or ‘Ba’ or below by Moody’s. Junk bonds are so called because of their higher default risk in relation to investment-grade bonds.

Bullish: a position that benefits when asset prices rise.

Mean reversion: The concept that a series of returns has a tendency to return to its average level over longer periods, even if shorter periods can exhibit wide swings.

Russell 1000 Value Index: A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Discount: When the price of an ETF is lower than its NAV.

Forward P/E ratio: Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.