

# VALUE, GROWTH OR NEITHER?

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Looking at equity markets as a conflict between [value](#) stocks and [growth](#) stocks has become a reflex for many market commentators. ‘Growth is beating value’ (or the other way around) is always a good headline.

As value stocks are defined basically as cheap stocks, it is possible to point to the value side of any index. Growth stocks are defined as stocks with above-average growth prospects, so again, it is possible to look at an index and point to the growthiest stocks. The main index providers have done exactly that by splitting their main indexes down the middle, into growth and value versions, since as early as the 1980s.

## Using Value and Growth to Explain the Last 10 Years

While simplistic, and playing into humans’ love of false dichotomies, this narrative explains the last 10 years of equity performance pretty well—from the overwhelming domination of growth stocks in a negative [interest rate](#) environment where investment was cheap, to the start of a value revival last year on the back of the most aggressive tightening cycle in decades.

Figure 1: Relative Performance of Growth vs. Value in the Last 10 Years



Sources: WisdomTree, Bloomberg 1/31/13–1/31/23. Growth is proxied by the MSCI World Growth Net TR Index (captures large and mid cap securities exhibiting overall growth style characteristics across 23 Developed Markets countries). Value is proxied by the MSCI World Value Net TR Index (captures large and mid cap securities exhibiting overall value style characteristics across 23 Developed Markets countries). Past performance is not indicative of future results and any investment may go down in value.

## What About the Other Factors? Didn’t Quality Perform Better over that Period?

However, most things in our world can’t be reduced to a simple choice between black or white, good or evil, tea or coffee. Academics have demonstrated over the last five

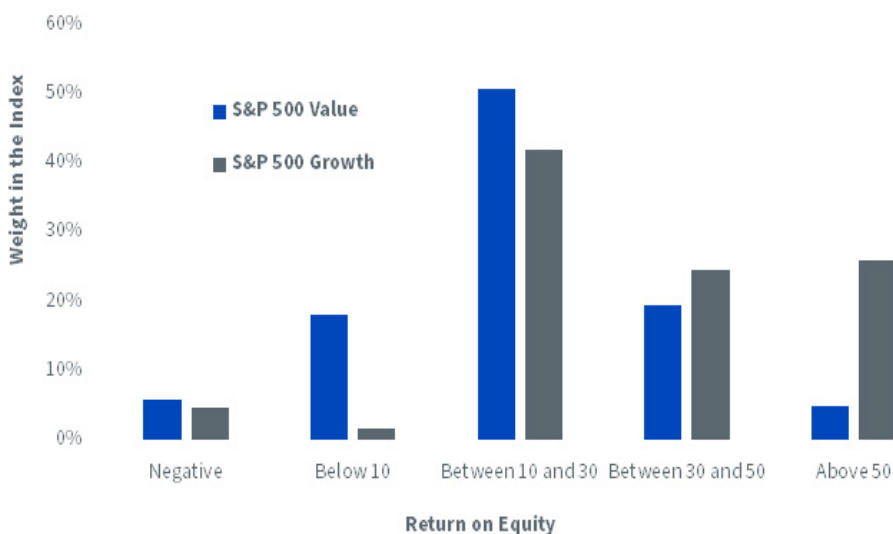
decades that multiple other factors can be used to slice and dice the markets to create outperforming portfolios. In the 1990s, Fama and French introduced their three-factors model, using value but also [size](#) and [momentum](#) to explain market returns. More recently, they added profitability (often called [quality](#)) and investment in a new five-factors model.

Looking at the performance of the seven leading factors over the last 10 years, we note that while growth beat the market by 1.6% per year and value underperformed by 1.9% per year, the strongest factor was, in fact, quality with an outperformance of 2.3% per year.

**Is Quality Value or Growth, then?**

Using quality as a third lens, we observe that companies in the value index are, on average, less profitable than those in the benchmark and that those in the growth index are, on average, more so. Of companies in the [S&P 500 value](#), 23% exhibit less than 10 in [return on equity \(ROE\)](#) versus less than 5% for the [S&P 500 Growth](#). And 25% of the S&P 500 Growth has more than 50 in ROE versus less than 5% for the value index.

**Figure 2: S&P Value & S&P Growth Holdings Split by Return on Equity**



Sources: WisdomTree, Bloomberg, as of 1/31/23. Return on Equity reflects the consensus estimate for Return on Equity, i.e., the mean of sell-side analyst estimates. Past performance is not indicative of future results and any investment may go down in value

However, what is fascinating is that in the value index, there are still some very profitable companies, and in the growth index there are still some unprofitable companies. In other words, the value/growth dichotomy is very different from the high quality/low quality one. The market could therefore be split, not into two indexes—value and growth—but into four:

- High-quality value
- High-quality growth
- Low-quality value
- Low-quality growth

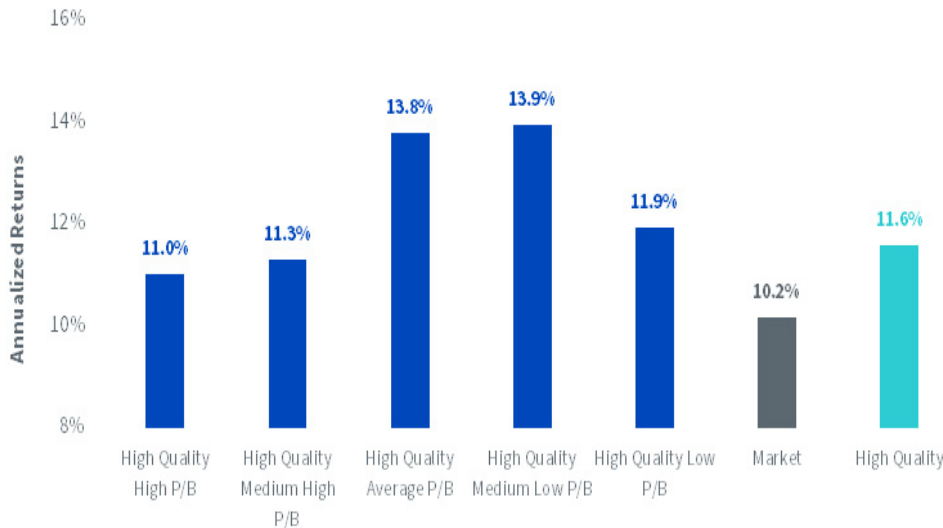
**Historically, High-Quality Value Outperformed High-Quality Growth**

Using academic data, it is possible to splice U.S. equity markets since the 1960s into groups by fundamental data. In figure 3, we focus every year on the 20% of the universe with the highest operating profitability (i.e., High Quality in figure 3). That group is then split into five further quintiles depending on their [valuations](#) (using [price-to-book](#) as a metric) from the cheapest to the most expensive.

In figure 3, we can see that picking profitable companies with high prices to book would

have outperformed the market since the 1960s, but would have underperformed profitable companies in general. In contrast, picking cheaper high-quality companies would have outperformed both the market and the overall high-quality grouping. In other words, quality value has outperformed quality growth over the last 60 years in U.S. equity markets. Looking at other geographies, such as Europe, we find similar results.

**Figure 3: Annualized Returns of High-Quality Portfolios of U.S. Stocks Based on their Valuations since the 1960s**



Source: Kenneth French Data Library. Data is calculated at a monthly frequency and from July 1963 to December 2022. High Quality represents the top 20% by operating profitability. The portfolios are rebalanced yearly at the end of June. The market represents the portfolio of all available publicly listed stocks in the U.S. All returns are in USD. Operating profitability for year t is annual revenues minus cost of goods sold, interest expense, and selling, general and administrative expenses divided by book equity for the last fiscal year-end in t-1. Past performance is not indicative of future results and any investment may go down in value.

At wisdomTree, we believe that a well-constructed quality strategy can be the cornerstone of an equity portfolio (see [here](#) and [here](#)). High-quality companies exhibit an ‘all-weather’ behavior that promises a balance between building wealth over the long term while protecting the portfolio during economic downturns. However, in 2022, secondary tilts were incredibly important. Value stocks benefitted from [central banks’ hawkishness](#), leaning on their low implied [duration](#) to deliver outstanding performance in a particularly hard year for equities. Among quality-focused strategies, the one with a value tilt delivered outperformance on average, and the one with a growth tilt tended to underperform.

Looking forward to 2023, [recession](#) risk continues to hang over the market like the sword of Damocles. While inflation has shown signs of easing, we expect central banks to remain hawkish around the globe as [inflation](#) is still very meaningfully above targets. The recent coordinated communication plan by [Federal Reserve Federal Open Market Committee](#) members is a further example of this continued hawkishness. With markets facing many of the same issues in 2023 that they faced in the second half of 2022, it looks like resilient investments that tilt to quality and value that have done particularly well in 2022 could continue to benefit.

**Quality Dividend Growth—A Recognized Quality Strategy with a Successful Track Record**

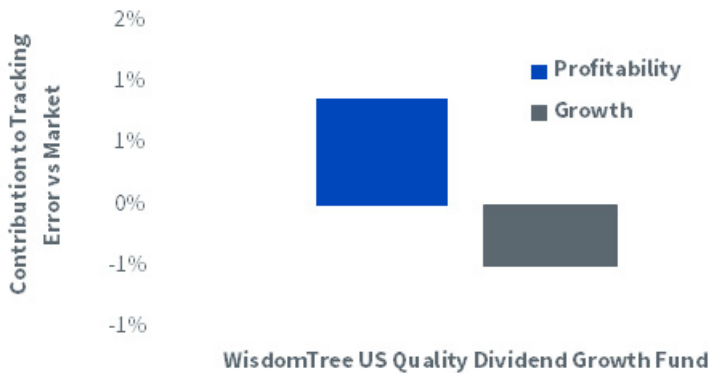
At wisdomTree, our [“Quality Dividend Growth” strategies](#) aim to leverage this quality and value partnership in the most efficient way. Our strategy, with \$11.6 billion<sup>2</sup> under management globally, focuses on high-quality companies that can grow their [dividends](#).

Our ETF portfolio is constructed around dividend paying companies with the best-combined rank of earnings growth, ROE and [return on assets](#) within a universe of companies with sustainable dividend policies. Stocks are also risk-tested using a proprietary [risk score](#)

en ([Composite Risk Score](#)), which uses quality and momentum metrics to rank companies and screen out the riskiest companies and potential value traps. Each company is then weighted based on its cash dividend paid ([market capitalization](#) x [dividend yield](#)), which introduces valuation discipline in this high-quality portfolio. Those steps in combination deliver a thoughtfully blended exposure to quality and value.

Figure 4 illustrates how the [WisdomTree U.S. Quality Dividend Growth Fund \(DGRW\)](#) delivers high exposure to profitability but also negative exposure to growth.

Figure 4: Factor Exposure of WisdomTree U.S. Quality Dividend Growth Fund



Sources: WisdomTree, Bloomberg, as of 1/31/23. Analysis is run on holdings of the ETF using PORT in Bloomberg. Factor definitions and calculations are explained in "U.S. or Global Equity Fundamental Factor Model" as relevant, which is available in PORT Help in Bloomberg. Past performance is not indicative of future results and any investment may go down in value.

<sup>1</sup> Sources: WisdomTree, Bloomberg. 1/31/13–1/31/23. Growth is proxied by the MSCI World Growth Net TR Index. Value is proxied by the MSCI World Value Net TR Index. Quality is proxied by MSCI World Quality Net TR Index. The remaining four factors (Min Vol, High Dividend, Small Cap and Momentum) are also proxied by indexes in the MSCI families. Past performance is not indicative of future results and any investment may go down in value.

<sup>2</sup> As of 2/8/23.

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Pierre Debru is an employee of WisdomTree UK Limited, a European subsidiary of WisdomTree Asset Management Inc.’s parent company, WisdomTree Investments, Inc.

For the top 10 holdings of DGRW please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/dgrw>

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.

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**IMPORTANT INFORMATION**

**U.S. investors only:** Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

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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.

**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.

**Interest rates**: The rate at which interest is paid by a borrower for the use of money.

**Size**: Characterized by smaller companies rather than larger companies by market capitalization. This term is also related to the Size Factor, which associates smaller market-cap stocks with excess returns vs the market over time.

**Momentum**: Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**Quality**: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**S&P 500 Value Index**: A market capitalization-weighted benchmark designed to measure the value segment of the S&P 500 Index.

**Return on Equity (ROE)**: Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**S&P 500 Growth Index**: A market capitalization-weighted benchmark designed to measure the growth segment of the S&P 500 Index.

**Valuation**: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Price-to-book ratio**: Share price divided by book value per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Central bank**: Refers to the the monetary authority of any country.

**Hawkish**: Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

**Duration**: A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

**Recession**: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

**Inflation**: Characterized by rising price levels.

**Federal Reserve** : The Federal Reserve System is the central banking system of the United States.

**Federal Open Market Committee (FOMC)** : The branch of the Federal Reserve Board that determines the direction of monetary policy.

**Dividend** : A portion of corporate profits paid out to shareholders.

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Risk screen** : A process of filtering, or removing, companies that are eligible for an investment process based on certain risk parameters.

**Composite risk score** : A term that refers to combining multiple factors—for example quality and momentum—to quantify the potential riskiness of a security relative to comparable companies.

**Market Capitalization** :  $\text{Market cap} = \text{share prices} \times \text{number of shares outstanding}$ . Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Dividend yield** : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.