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Is It Time for Value Stocks to Move Back into Favor?
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Equity style categories may be defined as value or growth to better understand risk and diversification. Among the 11 industry sectors, history reveals dominate themes that drive one style over the other. For the past several years, growth stocks have left value stocks in the dust, as technology companies were helped in part by Trump's corporate tax cut. However, value stocks that include cyclicals like banks and energy have been hammered down by zero interest rates. Large energy company stocks, which offer attractive yields, have suffered from low oil and natural gas prices.

Value stocks trade at lower price to earnings and book value multiples than growth stocks. During 2020, many value stocks, especially those in utilities, transportation, and materials became discounted further due to COVID. This caused their dividend yields to become very attractive, bettering a typical bond portfolio. In fact, the yields of value stocks are increasingly becoming a viable alternative to bonds.

During the first nine months of 2020, the return disparity between large-cap growth and value stocks reached 37 points (+23.3% vs. -13.4%). While the S&P 500 index earned +5.5% for the first nine months of 2020, Amazon surged +69%, followed by Apple (+54%), Microsoft (+31%), Facebook (+27%), and Alphabet (+8.7%). While corporate earnings growth is at the core of stock performance, these stocks grew much faster than profits. Apple's share price doubled in the past 24 months, while its profits remained unchanged.

A Biden win to the White House may lead to a repeal of the Trump corporate tax regulations that lifted growth sectors, such as technology. According to BofA (WSJ 10/5/20), Biden's higher corporate tax proposal for both domestic and foreign earnings is expected to hit tech stocks hard. In addition, possible antitrust violations being investigated by the Federal Trade Commission of Facebook and Google may be vigorously prosecuted in the near future.

History reveals that growth and value stocks reach tops and bottoms, but at different times. Both categories tend to be out of phase by comparison during nearly every economic cycle and that is why asset allocators like to include both.

During the 1997-2000 period, growth stocks were rocketed into outer space by the nascent dot.com era. Many investors were convinced of a new paradigm where technology and the information highway were the future. Recommendations to rotate back to value from growth in 1999 fell on deaf years or to some people seemed like a joke. It should be pointed out that the ensuing collapse of growth was led by companies having meteoric price to book multiples and having no positive earnings. These became betting parlor stocks that soon disappeared. Value did come back with a vengeance, as investors learned a valuable lesson that owning real companies having sustainable earnings and dividends is not such a bad thing after all.

Today's growth stocks may in fact have more sustainable business models than those of the late 1990s. But no cycle lasts forever. A sea change that includes higher corporate tax rates, rebuilding of America's infrastructure, rising interest rates, and higher oil and gas prices could shift investor sentiment back to cyclical value stocks. In fact, this shift may have already begun in September 2020.

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