Value Investing Is Dead? No, Long Live Value!

Emidio Checcone & Brian Ear | March 2021

"Stocks aren't cheap and popular at the same time."

– Anonymous

"The stock market is filled with individuals who know the price of everything, but the value of nothing."

– Philip A. Fisher

After reaching historic levels of cheapness by the end of 2019, value stocks underperformed growth stocks by a country mile in 2020, setting an all-time record for value's cheapness relative to growth.[1] Given the more-than-decades-long underperformance of value, proclamations of the death of value investing are proliferating as they did during past periods of such underperformance before value again rewarded investors' patience.[2] Such declarations are predicated on a variety of arguments: 1) the concept of book value is flawed (we agree); therefore, the value stocks are unattractive (we disagree); 2) technology has ushered in a new era of winner-take-all platforms and capital expenditure (capex)-light high-growth companies; 3) creative destruction and lax antitrust regulation have created megacap winners and smaller-cap losers of historic proportions; 4) record low interest rates have stifled value investing as an effective investment style; and 5) too many investors are pursuing value investing. In this paper, we believe that we show each of these arguments are misconceptions.

Thus, we demonstrate an investment opportunity in the epic cheapness of value as measured by metrics of the so-called value spread.[3] In U.S. large-cap equities, value spread is real and compelling relative to growth stocks. Furthermore, to the extent investors maintain permanent allocations to U.S. equities, given the protracted, more-than-decadelong run of growth relative to value, it is logical to consider a reallocation of some of that capital away from growth and into value. To paraphrase Mark Twain, the reports surrounding the death of value investing have been greatly exaggerated. Indeed, value stocks have rarely, if ever, appeared so attractive relative to growth stocks.

The Value Spread: Metrics and History

We define value spread as the difference in valuation between the most- and least-expensive stocks using various valuation metrics (i.e., taking the top half minus the bottom half of stocks, ranked by expensiveness using various metrics). Here is the differential between the top half and bottom half of stocks within the S&P 500 Index valued using the price-to-book (P/B) ratio, the valuation metric favored in academic literature. *(Figure 1)*

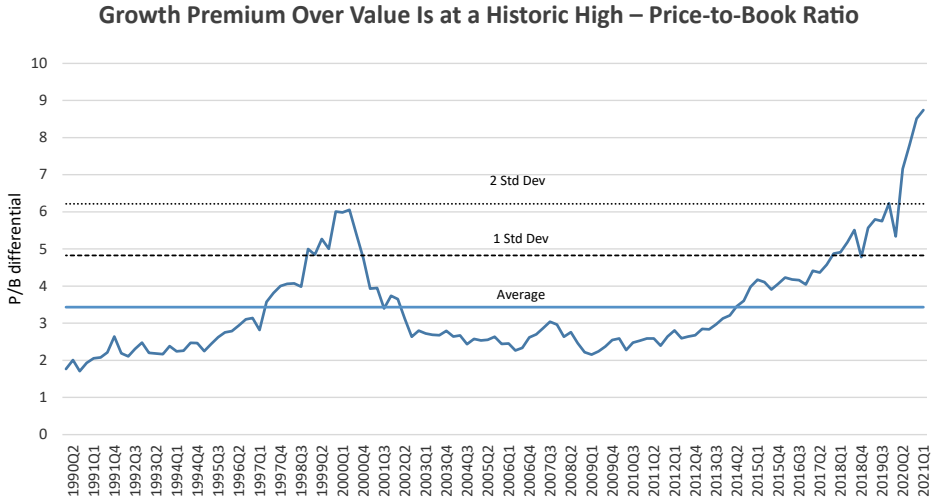

Figure 1
S&P 500 Companies, Ranked by P/B Ratio
Source: FactSet, DoubleLine

By the end of 2019, the value spread, using the P/B valuation differential, had already exceeded all prior highs of the S&P 500. Then came massive fiscal and monetary stimulus in 2020 in response to the COVID-19 pandemic and economic shutdown. That stimulus drove the spread to further extremes, dwarfing even its prior peak during the technology bubble of the late 1990s.

Now, let us turn to the five misconceptions that have caused some growth and tech champions to miss today's compelling value spread.

Misconception No. 1
Book Value Is Flawed. Therefore, No Compelling Value Spread Exists

It is true that book value is a flawed measure for determining the value of a company. This is because book value is a backward-looking measure of value – and an imperfect representation of that historical value. As a backward-looking measure, P/B fails to capture the value of the cash flows that a company might reasonably expect to achieve – and shareholders to enjoy – in the future. Specifically, the measure fails to capture expensed (as opposed to capitalized) investments in research and development expenditures that add to corporate know-how, or in sales and marketing costs that add brand equity to a company. Accountants have long pointed out that the value of a company's intangible factors are excluded from book value calculations in the U.S., and this shortcoming tends to make intangible-rich companies, like technology firms or consumer companies with strong brands, look expensive relative to tangible-heavy companies. Over the last few decades, the impact of this mismeasurement has been large and has disproportionately impacted growth stocks. Additionally, book value can look different for two similarly situated companies that have made different decisions about share repurchases or mergers and acquisitions activities in the past. A company that repurchases its shares above book value will distort its P/B relative to a hypothetically identical industry peer that has not made such buybacks. Similarly, a company that chooses to employ R&D expenditures for growth will look more expensive on P/B than a company that achieves that growth through an acquisition at a premium since that goodwill is added to book value. Because of these growing inconsistencies, P/B is increasingly a problematic measure of corporate value.

While the critique of book value is correct, it does not go very far in undermining the observation that value stocks are cheap. Indeed, most value investors do not rely upon P/B at all when undertaking equity research on a prospective investment. Instead, the value investor models out and discounts future cash flows in order to ascertain a company's intrinsic worth.[4] This is the approach to value investing practiced at DoubleLine.

Importantly, our analysis avoids some of the problems unique to book value by employing other valuation metrics rooted not in the balance sheet but in the income and cash flow statements. These include the price-to-sales (P/S) ratio, the trailing price-to-earnings (P/E) ratio, the forecasted next-12-months (NTM) P/E ratio, the enterprise-value-(EV)-to-earnings-before-interest-taxes-depreciation-and-amortization (EBITDA) ratio, the EV-to-operating-cash-flow (OCF) ratio, the EV-to-free-cash-flow (FCF) ratio and a more normalized presentation of EV to FCF. As can be seen in the following charts, the valuation spread (i.e., the cheapness of value versus growth stocks) is at historic levels under a variety of different valuation metrics. *(Figures 2-8)* For a more visually concise presentation of these valuation metrics, we have incorporated the historical data of these charts into a summary bar chart. *(Figure 9)*

Growth Premium Over Value Is at a Historic High – Price-to-Sales Ratio

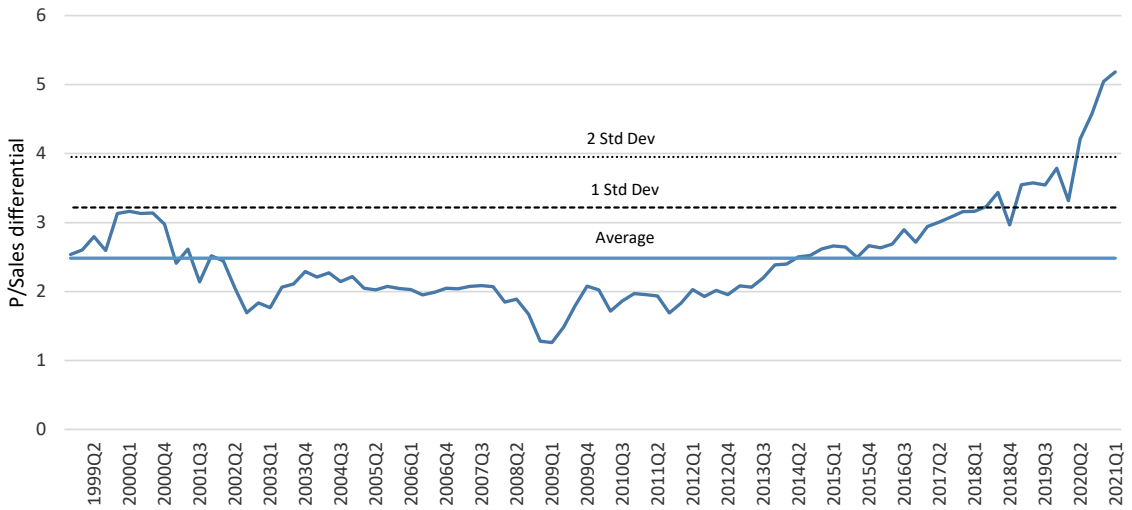

Figure 2
S&P 500 Companies, Ranked by P/S Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High – Forecasted Next-12-Months Price-to-Earnings Ratio

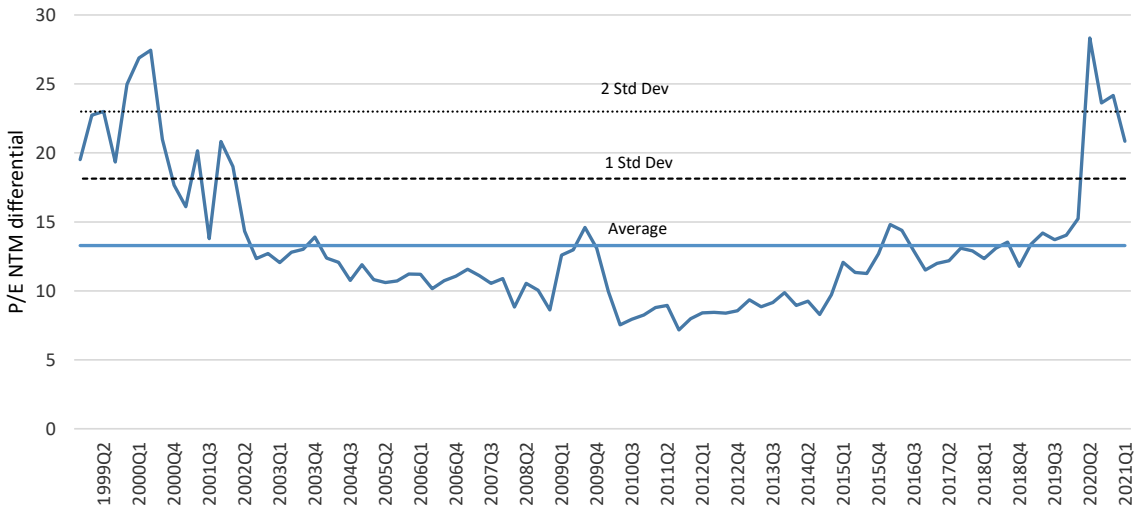

Figure 3
S&P 500 Companies, Ranked by Forward P/E Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High – Trailing Price-to-Earnings Ratio

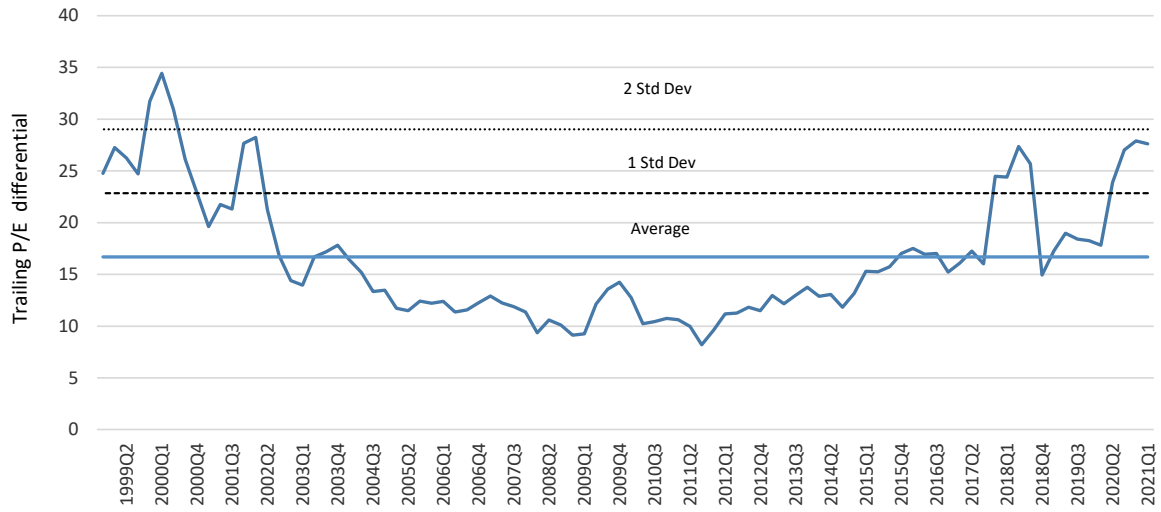

Figure 4
S&P 500 Companies, Ranked by Trailing P/E Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High – Enterprise-Value-to-EBITDA Ratio

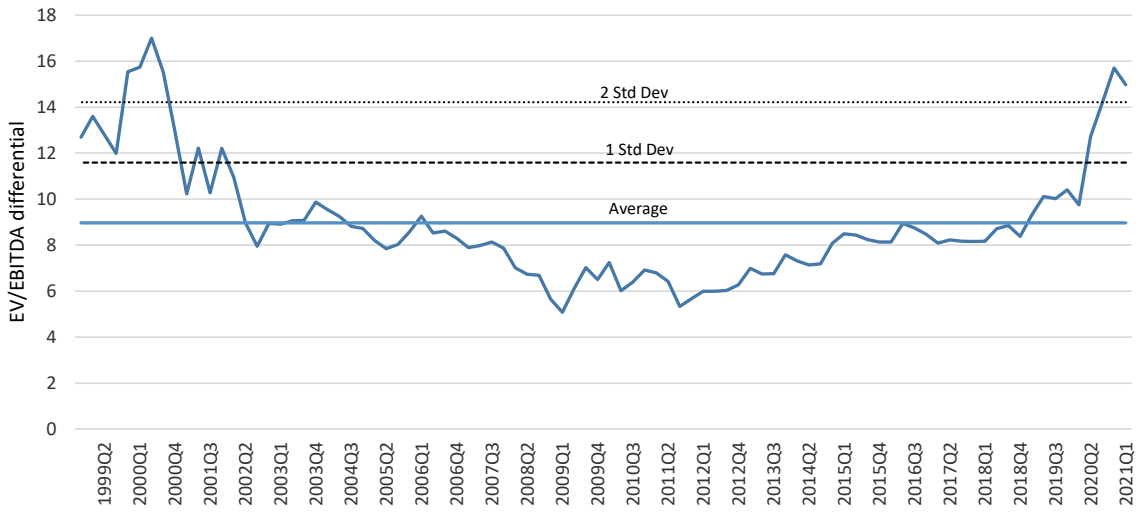

Figure 5
S&P 500 Companies, Ranked by EV/EBITDA Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High – Enterprise-Value-to-Operating-Cash-Flow Ratio

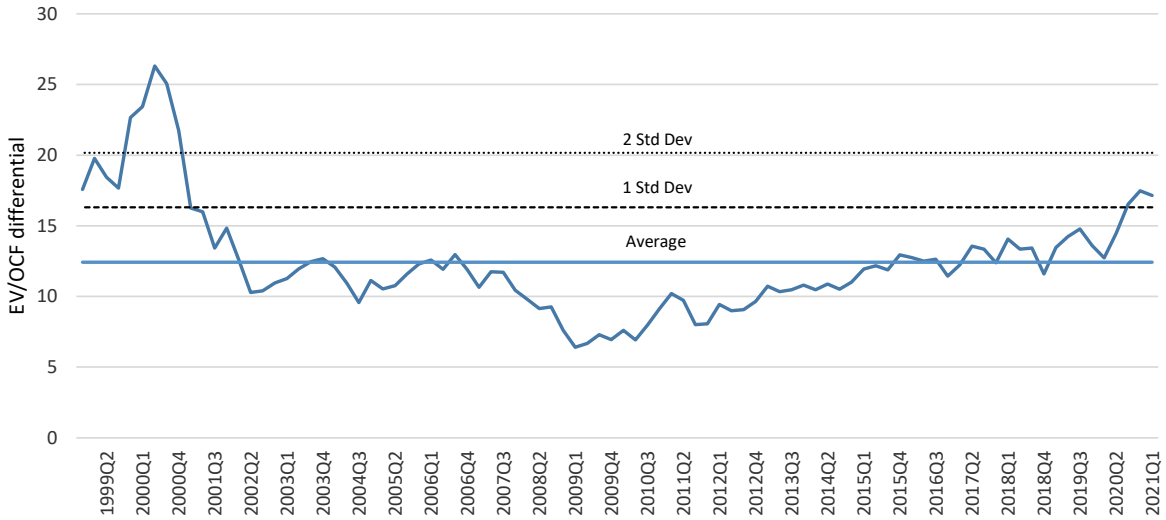

Figure 6
S&P 500 Companies, Ranked by EV/OCF Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near the Historical Average – Enterprise-Value-to-Free-Cash-Flow Ratio

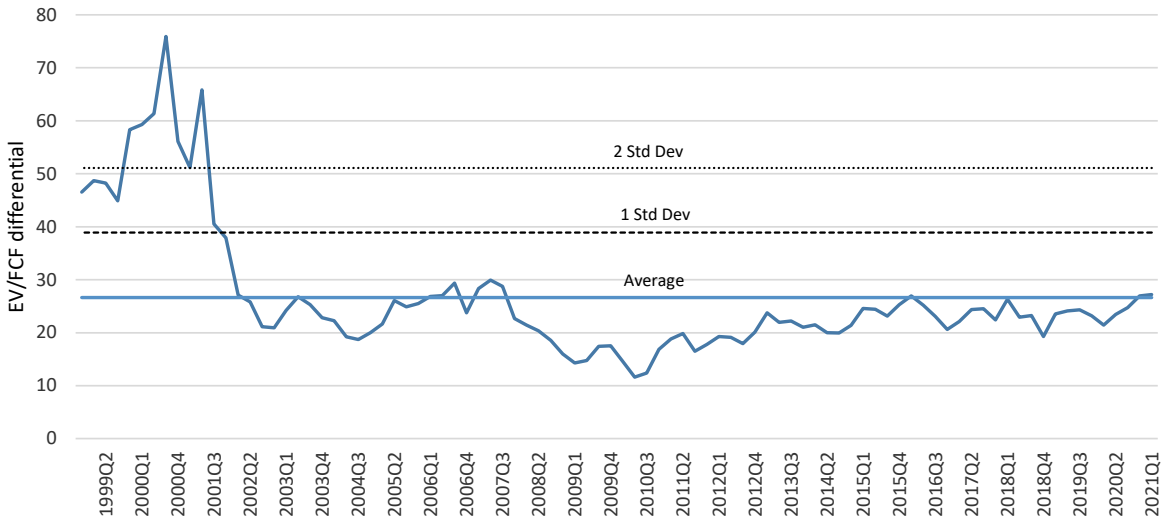

Figure 7
Value Stocks in the S&P 500, ranked by EV/FCF Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High – Enterprise-Value-to-Operating-Cash-Flow (Less Depreciation and Amortization) Ratio

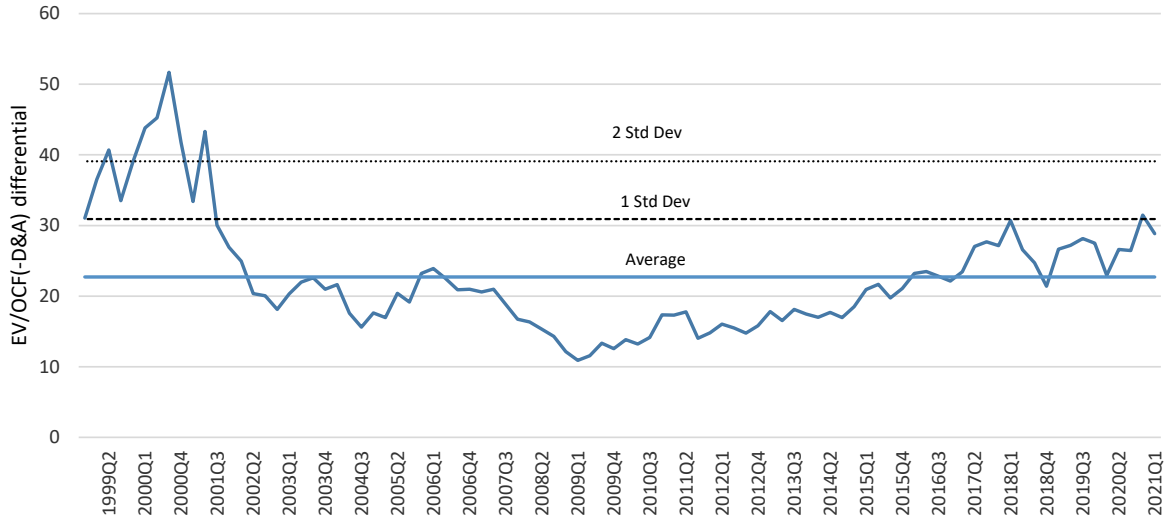

Figure 8
S&P 500 Companies, Ranked by EV/OCF (-D&A) Ratio
Source: FactSet, DoubleLine

Growth Premium Over Value Is Near a Historic High Across Most Valuation Multiples Except EV/FCF Ratio

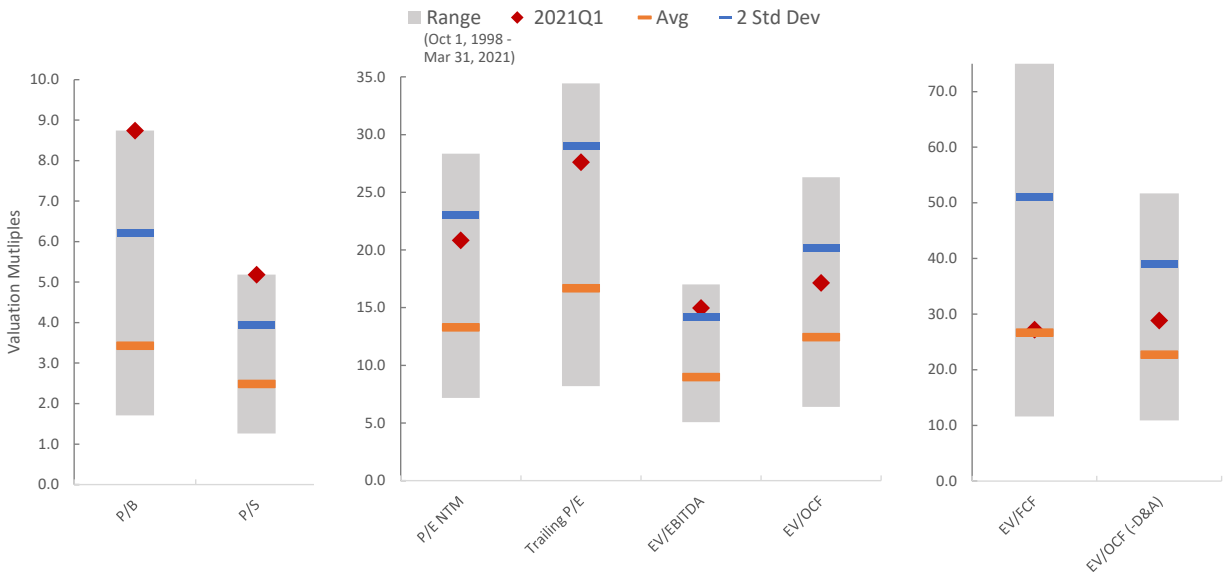

Figure 9
S&P 500 Companies, Ranked by Various Valuation Metrics
Source: FactSet, DoubleLine.

With the apparent exception of the EV/FCF multiple (to which we will return), these alternative measures show that the value spread has reached extreme widths on a historic basis. Each of these metrics has its limitations, which is why we assess them in the aggregate. Yet, they all tell a similar story: Value stocks are two standard deviations cheaper than their historical average, and under some measures, they show value stocks are as cheap as they have ever been.

Now, a couple of caveats. First, P/S is not a strong measure of value across different industries or sectors given their varying margin profiles. Therefore, we examine the value spreads using P/S *within* sectors rather than *across* them. For example, we do not allow a high-margin sector like technology to dominate the high-P/S cohort when being compared to the low-P/S cohort, which is dominated by a low-margin sector like energy. Instead, we compare the high- and low-P/S stocks within sectors and then aggregate them to a marketwide value spread on a harmonic weighted market capitalization basis. When we neutralize the structural differences in P/S across sectors, we find that the value spread is still very compelling – exceeding prior peaks and deviating more than two standard deviations above the mean – based on this valuation metric.

Growth Premium Over Value Is at a Historic High – Average Intrasector P/S Ratio

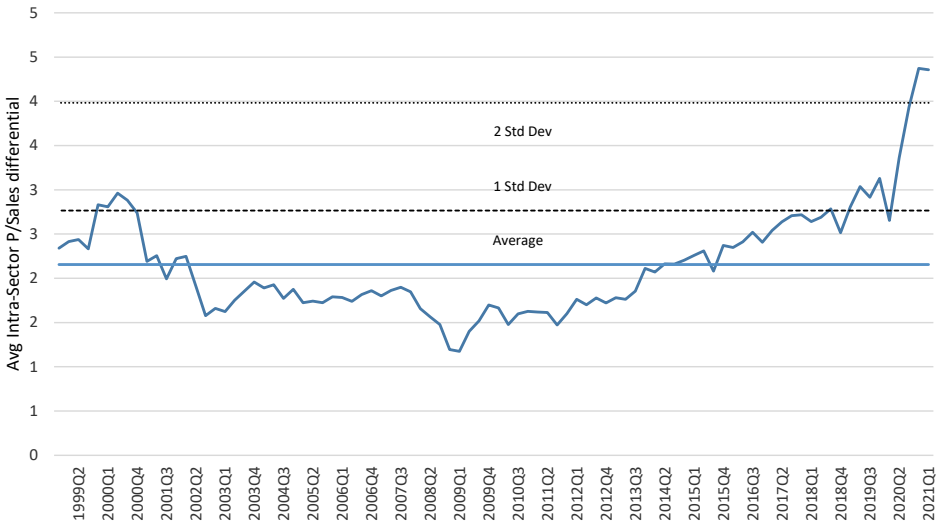

Figure 10
S&P 500 Companies, Ranked by P/S Ratio Using Intrasector Analysis
Source: FactSet, DoubleLine

Growth Premium Over Value Is High for Most Sectors – Intrasector P/S Ratio

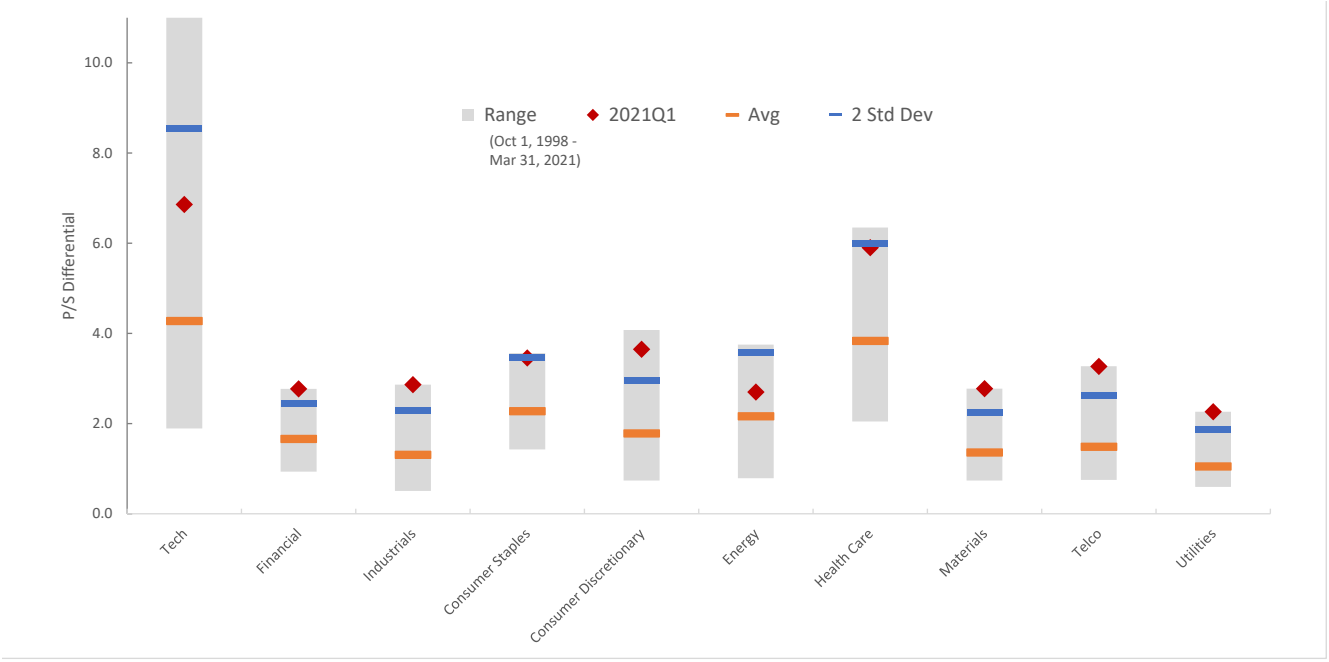

Figure 11
S&P 500 Companies, Ranked by P/S Ratio Within Sectors
Source: FactSet, DoubleLine

Secondly, as noted earlier, the EV/FCF metric would appear to show that the value spread is not remotely as wide as it became during the height of the technology mania of the late 1990s. Instead, it appears to be more in line with its historical average. *(Figure 7)* Some market participants point to the FCF multiple as a key argument in the defense of growth and momentum equity valuations.[5] However, the EV/FCF metric is subject to the volatility and cyclicality of capex, working capital and other determinants of FCF. Capital spending for companies in capital-intensive industries is usually based on long-term plans and tends to be lumpy. At times, the capex cycle might differ from the economic cycle. *(Figure 12)* In addition, when a downturn occurs, adjustments to capital spending tend to occur much slower than the decline in profitability. Therefore, EV/FCF valuation spread can also be influenced by the timing of the capital spending cycle for cyclical companies. Our theory is that the superior FCF of growth companies is a reflection of where we are in the business cycle. If that is the case, one must normalize those cash flows to a cyclical average in order to make a proper comparison with value companies. To test this theory, we have attempted to obtain a more cyclically normalized FCF measure by employing depreciation and amortization (D&A) as a more stable proxy for corporate capex. Our reasoning is that future capex should approximate the historical averages of capex that generate such D&A on those balance sheets. By replacing FCF with the difference between OCF and D&A (i.e., our substitute for capex), we arrive at an enterprise multiple of our normalized FCF. *(Figure 8)*

S&P 500 Margin and Capex: The Capex and Economic Cycles Are Not Always in Sync

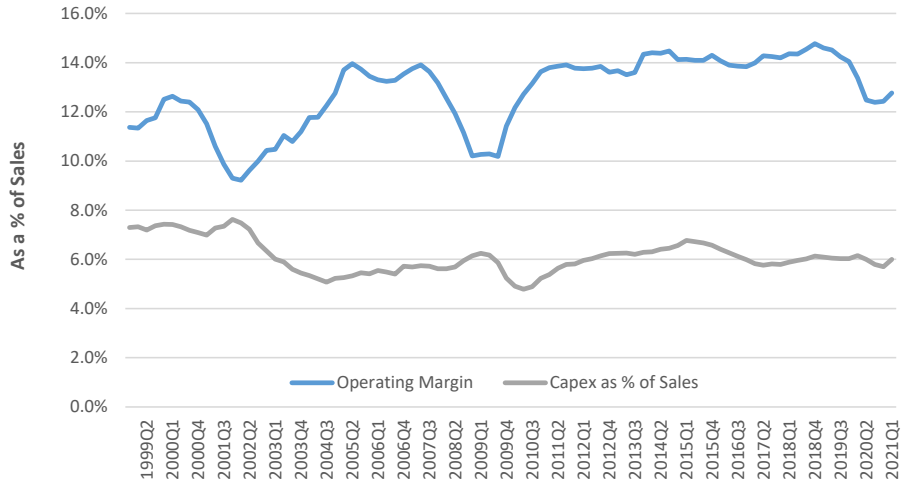

Figure 12
S&P 500 Operating Margin and Capex Spending as a % of Sales Through Economic Cycles
Source: FactSet, DoubleLine

Calculated on this basis, the extreme value spread appears again, and with a magnitude similar to other valuation metrics, such as OCF, EBITDA or earnings (i.e., nearly two standard deviations). Figure 8 highlights the risks of relying upon a static FCF multiple without normalizing its constituent drivers for the fluctuations that occur in business and economic cycles.

Misconception No. 2
This (High-Tech) Time, It's Different

Decades ago, investing legend Sir John Templeton warned investors about the four most dangerous words in investing: "This time it's different." Notwithstanding that ageless counsel, new-era thinking periodically resurfaces during asset bubbles. That recurring trait of market manias has reemerged as a justification for the very high valuations carried today by growth stocks, particularly in technology-related sectors. Advocates for highly valued technology stocks point to the unique aspects of these growth companies. Specific factors include the superstars' ability to disrupt older competitors, their reliance on capex-light business models and their low reliance on labor investments. Indeed, the financial press has spilled much ink extolling the virtues of digital disruption, noting the winner-take-all dynamics of multisided platform companies and cautioning on the challenges facing large swaths of the labor force in a world in which labor-light Facebook takes up the growth mantle from makers of physical stuff and large employers. These unique characteristics allow today's technology behemoths to generate secular growth rates and returns on assets and equity that are structurally and permanently advantaged over companies born before the digital age. While the benefits of digital transformation are undeniable, these arguments appear to have crossed over into new-era thinking insofar as the valuations appear to not only reflect these advantages but to over-represent them. In other words, we are seeing what we believe is perhaps an irrational bubble of belief surrounding digital disruption in growth stock prices.

This is not the first time the world has experienced elevated levels of technological disruption. In those prior episodes, value stocks still delivered relative outperformance. Indeed, value has outperformed growth over long periods of time that include similar periods in which new technologies were busy disrupting our lives in similarly transformative ways. This financial history spans from the advent of the telegraph and railroads to the development of the personal computer and gene splicing, from the proliferation of automobiles and copy machines to the spread of the smartphone and online commerce. Moreover, time and time again the historical pattern of such new-era thinking has ended in a boom-bust crash, as happened most recently in the early 2000s.

We believe that the market has overextrapolated the value of technological disruption to sustain multiples that cannot be rationally justified. To demonstrate the speciousness of these new-era arguments, we assume a hypothesis that technology stocks found in the information technology and communications sectors fully or mostly explain the currently stretched valuation spread.[6] If the new-era thinking were correct, then exclusion of technology and communications stocks from the data set would meaningfully diminish the value spread. This in fact did not occur. With the tech and telecom names excluded, the valuation spread remains compellingly wide as measured by P/B, P/S, trailing P/E, forecasted next-12-months P/E (as measured by consensus forecast), EV/EBITDA and the EV-to-normalized-free-cash-flow-proxy ratio. *(Figure 13)*

Growth Premium Over Value Is Near a Historic High Even Excluding Information Technology and Communication Services

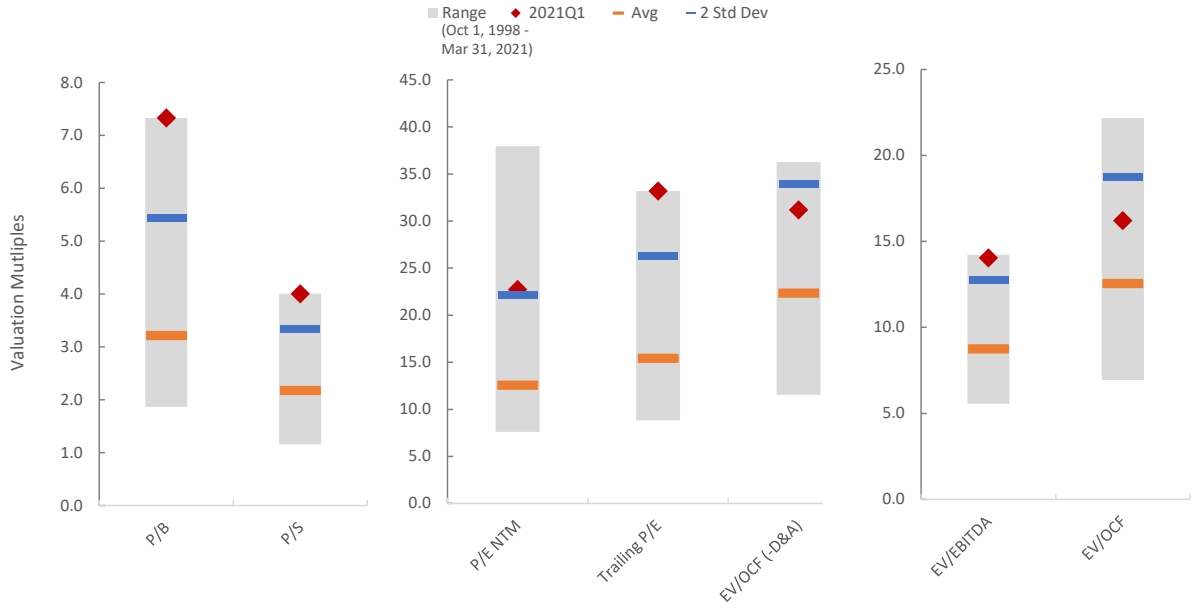

Figure 13
S&P 500 Companies, Excluding Information Technology and Communication Services Names, Across Various Valuation Metrics
Source: FactSet, DoubleLine

The charts in Figure 13 highlight that the value spread is nearly as wide with technology names excluded as with them included. In other words, growth is overpriced to value as much outside of the technology sectors as within them. Thus, while today's technology companies have defied the gravity of historical valuation ranges, that fact and the narratives construed from it fail to explain the prevalence of today's extreme value spread.

Misconception No. 3
The (Super) Stars Will Shine

In a related argument often raised to justify the heightened value spread, some commentators observe that technology, globalization and lax antitrust enforcement have given rise to so-called superstar companies.[7] These companies exploit scale, scope, network effects and related competitive advantages to grow their market share, sales, earnings, cash flow and investment returns disproportionately and often at the expense of less well-positioned firms. Moreover, because their stock prices and valuation multiples expand relative to the rest of the indexes, these megacap superstars become increasingly represented within the mix of companies forming major equity indexes, such as the S&P 500. As a result, these companies' extended outperformance supposedly explains the widened value spread. In short, in this era of elevated creative destruction, so this argument goes, the value spread ought to be at or above prior highs.

To test this hypothesis, we again engaged in addition by subtraction. If the superstar company theory for the extreme value spread is valid, then removing the superstars from the data set ought to slash the observed value spread. To cull the superstars, we conducted three alternative experiments. First, we eliminated from the historical data set the top 5% of companies by market capitalization, since the superstar companies of the current era, like those of past periods, grew to become megacap firms. Second, we eliminated from the historical data set the top 10% most-expensive companies, since the superstar companies of the current era, like those of past periods, became among the most highly valued in the market. Finally, we compared the profitability of the highest-multiple stocks with the lowest-multiple stocks by looking at their margin and return-on-asset (ROA) differentials over time. The underlying assumption being tested in these experiments is that the superstar companies are recognized as such and thus carry higher multiples and predominate in the high-multiple stock cohort. If the competitive advantages among these superstar companies among the growth stocks were ubiquitous and persistent, then we would expect the margin and ROA differentials between the superstar-enhanced growth cohort to widen meaningfully vis-à-vis value stocks over time.

Applying all three of these adjustments to the same array of valuation measures employed earlier, the value spread remains largely unchanged. First, we show the analysis excluding the megacap companies. *(Figure 14)*

Growth Premium Over Value Is Near a Historic High Even Excluding Megacap Stocks

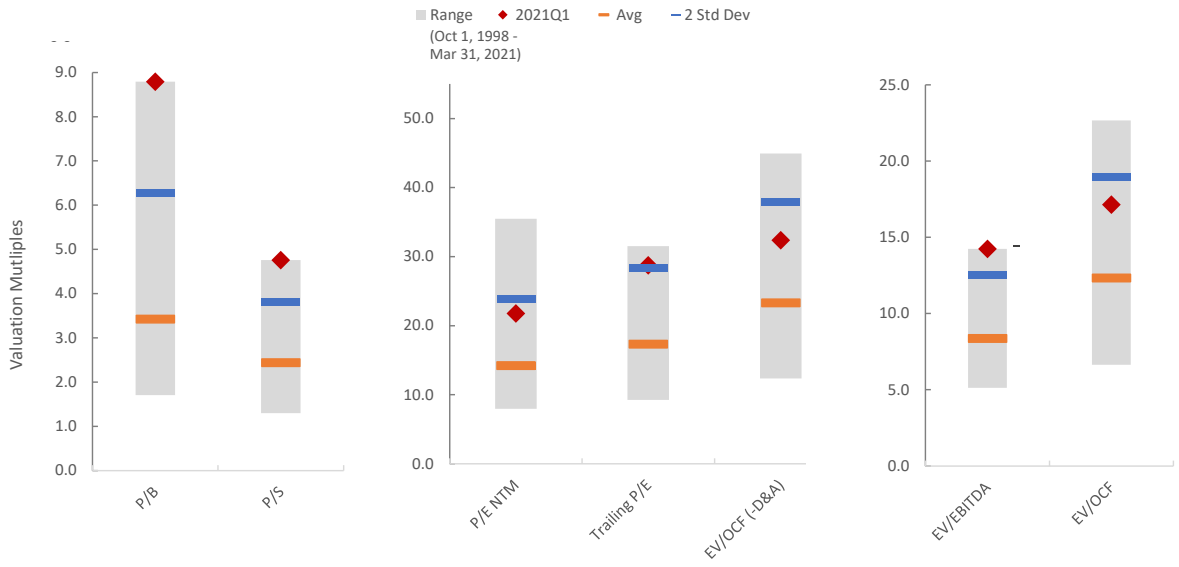

Figure 14
S&P 500 Companies, Excluding the Top 5% of Firms by Market Cap, Across Various Valuation Metrics
Source: FactSet, DoubleLine

Next, we show a similar analysis that excludes the top 10% most-expensive companies' shares. *(Figure 15)*

Growth Premium Over Value Is Near a Historic High Even Excluding Top 10% Highest Valuation

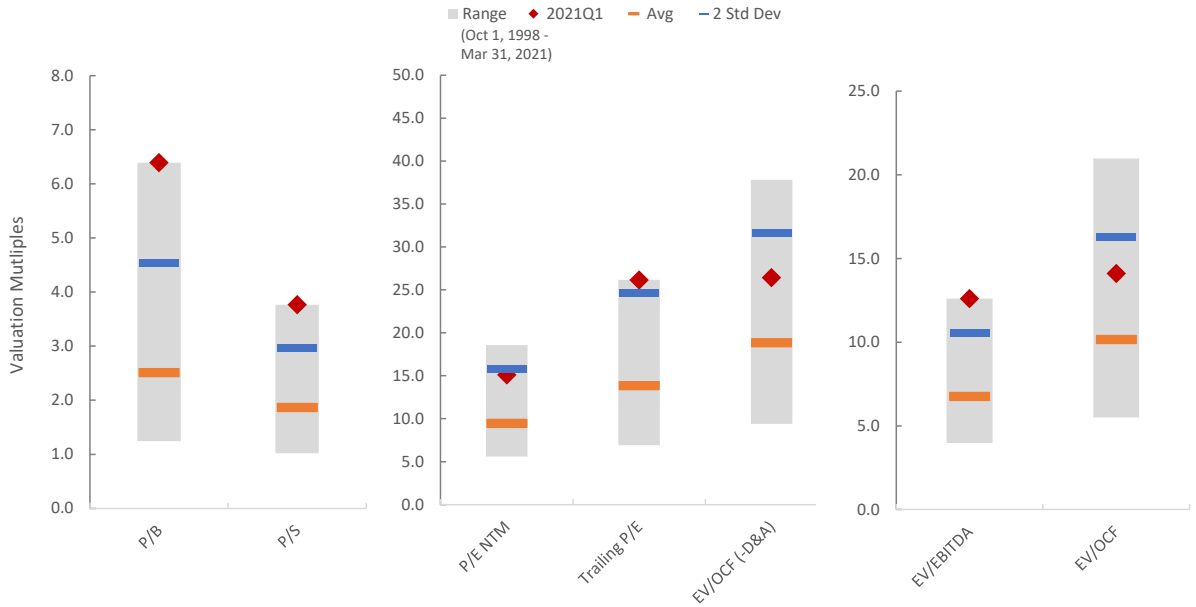

Figure 15
S&P 500 Companies, Excluding the Top 10% Most-Expensive Firms, Across Various Valuation Metrics
Source: FactSet, DoubleLine

Next, we present the charts showing that the relative profitability of growth stocks has not increased significantly versus history. *(Figures 16-18)*

Growth and Value Relative Margins Have Not Deviated Much From History – Average Intrasector P/B Ratio

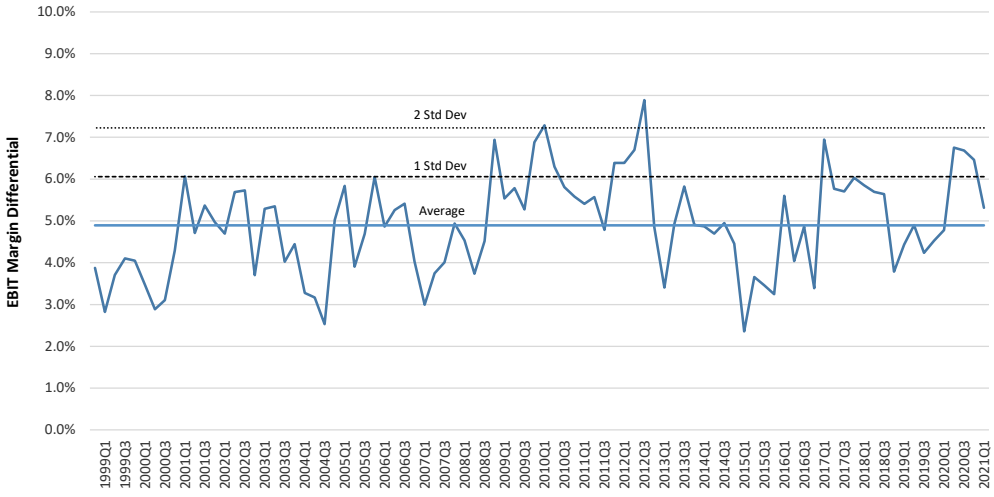

Figure 16
EBIT Margin of S&P 500 Companies, Ranked by P/B Ratio
Source: FactSet, DoubleLine

Growth and Value Relative Margins Have Not Deviated Much From History – Average Intrasector P/S Ratio

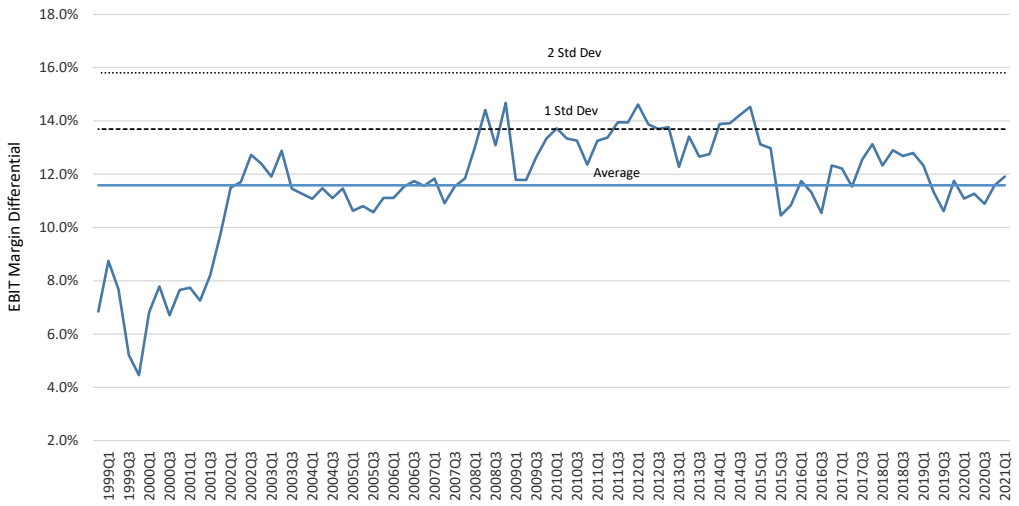

Figure 17
EBIT Margin of S&P 500 Companies, Ranked by Intrasector P/S Ratio
Source: FactSet, DoubleLine

Intrasector Growth and Value Operating Margin Differential Remains Near Its Historical Average For Most Valuation Metrics

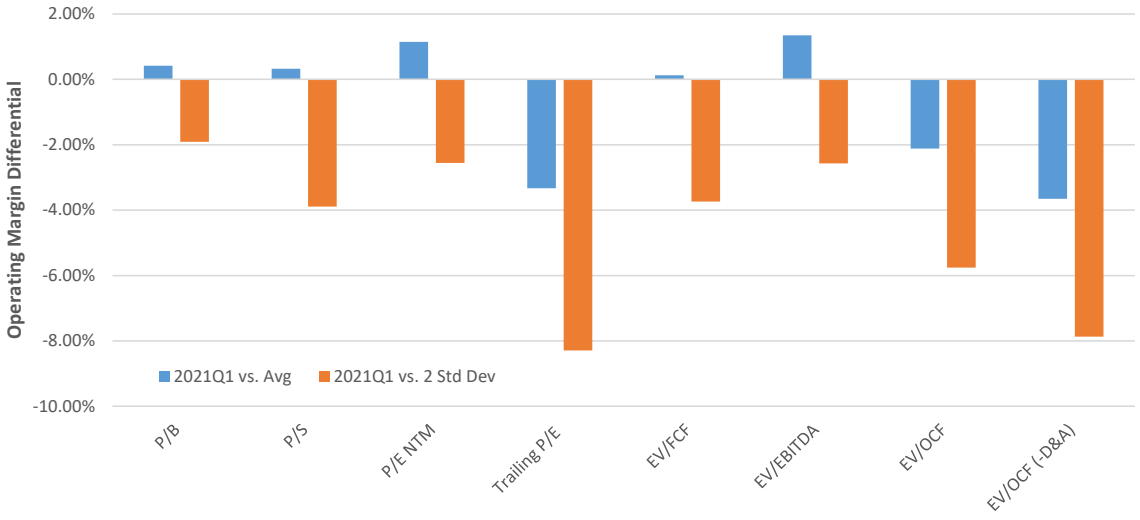

Figure 18
EBIT Margin of S&P 500 Companies, Across Various Valuation Metrics
Source: FactSet, DoubleLine

Finally, the charts below also show that the ROA of growth stocks relative to that of value stocks has not changed substantially either. *(Figures 19-21)*

Growth and Value Relative ROA Has Not Deviated Much From History – Average Intrasector P/B Ratio

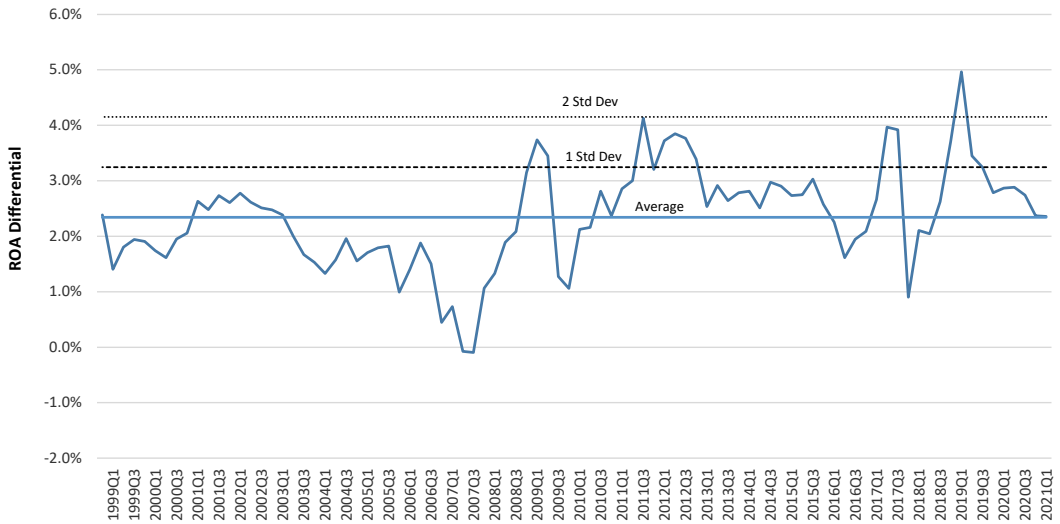

Figure 19
EBIT Margin of S&P 500 Companies, Ranked by P/B Ratio
Source: FactSet, DoubleLine

Growth and Value Relative ROA Has Not Deviated Much From History – Average Intrasector P/S Ratio

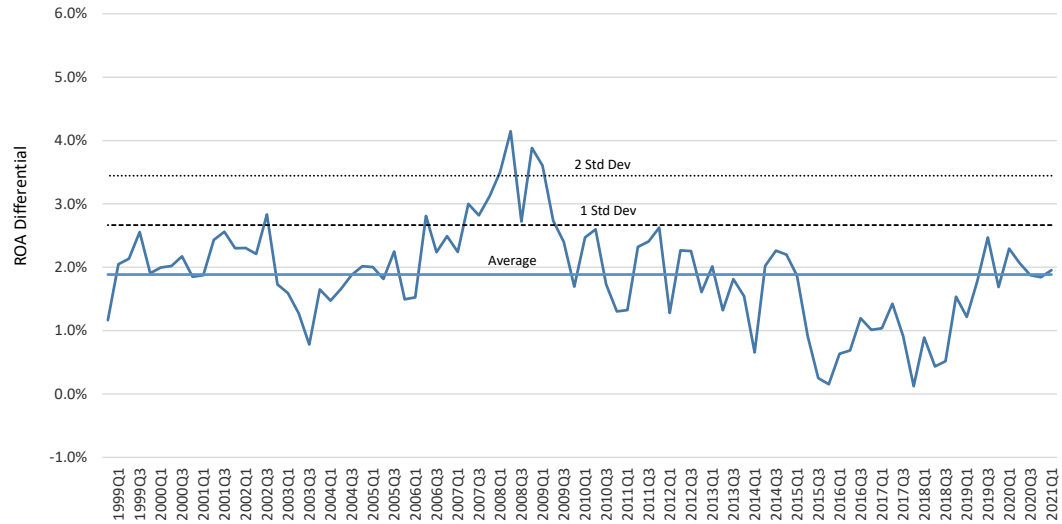

Figure 20
EBIT Margin of S&P 500 Companies, Ranked by P/S Ratio
Source: FactSet, DoubleLine

Intrasector Growth and Value Return on Assets Differential Remain Near Its Historical Average For Most Valuation Metrics

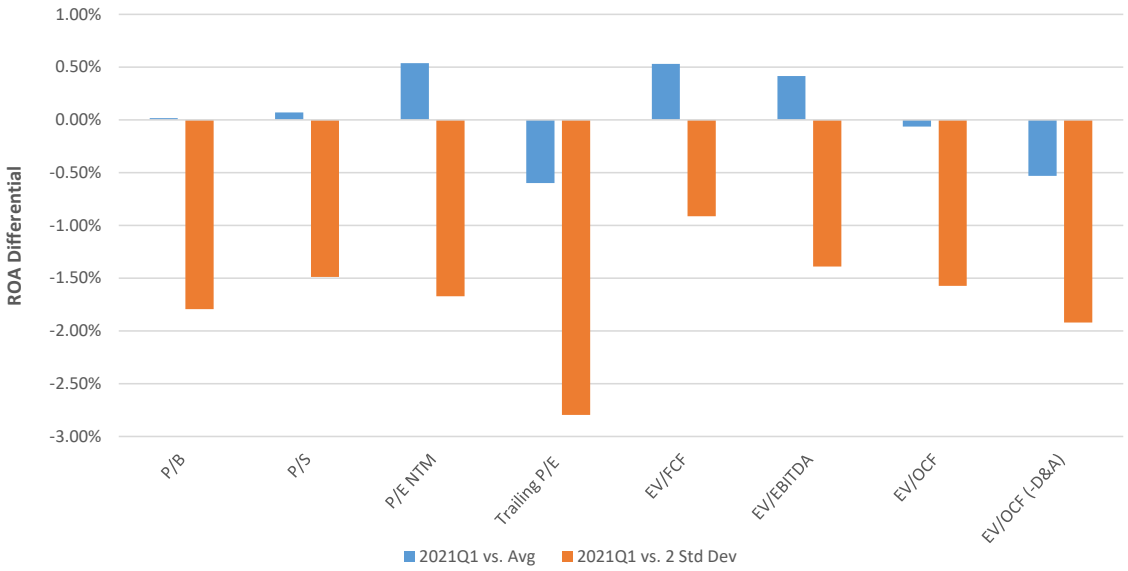

Figure 21
EBIT Margin of S&P 500 Companies, Across Various Valuation Metrics
Source: FactSet, DoubleLine

As Figures 14 and 15 show, the value spread is extremely wide even after excluding those names that would be categorized as superstar firms based on megacapitalization and outsized valuation. Meanwhile, according to Figures 16 through 21, the margin and ROA differentials remain relatively consistent with history, implying that higher multiples for the superstar-enhanced growth cohort have not been driven by superior profitability. This suggests that the competitive advantages are not widespread among growth stocks and might be more isolated to a few superstar firms (e.g., Google, Amazon and Microsoft), making it problematic to extrapolate the unique advantages of a few superstar firms to the wider growth stock cohort, as the value-stock-shunning, growth-stock-seeking investment community appears to be doing, driving the current value spread.

While the academics and economists could be correct about the causes and implications about the emergence of superstar firms, the use of such narratives to justify the current value spread in the U.S. stock market appears misguided. Even setting aside these behemoths, there appears to be a systematic overlooking of value stocks that exceeds even the excesses of the large-cap growth mania of the late 1990s when General Electric was lauded as a world-beater megacap alongside such tech giants as Cisco Systems, Intel and Microsoft.

Misconception No. 4
Low Rates Lay Low Value Investors

A separate explanation, heard more often of late, attributes the wide value spread to ultralow nominal and real interest rates. The idea is that low interest rates benefit growth stocks more than value stocks because growth stocks are expected to generate substantial cash flow further out into the future, whereas value stocks are expected to generate cash levels consistent with historical levels with limited growth. In other words, to borrow an idea from fixed income investing, the duration of a value stock tends to be lower than that of a growth stock. Because higher-duration assets by mathematical definition are more sensitive to changes in interest rates than lower-duration assets, and because lowered rates increase the multiple associated with such cash flows, growth stocks should see higher valuations relative to value stocks as rates fall. Therefore, the value spread, under this argument, should be more pronounced in periods in which rates are very low.

Yet there are some problems with this story. First, fixed income products carry much more certain cash flow characteristics than those of stocks, even accounting for such issues as options allowing callability, conversion or prepayment. Future cash flows for equities are much less certain and more prone to over- and underestimation. These uncertainties can have a greater impact on valuations on a specific company than changes in interest rates. As a result, the valuations of equities do not follow with near-mathematical certainty the movements of interest rates. Second, it is often hard to know whether rates are the key causal factor driving the discount rate of all future cash flows or instead are serving as a proxy or signal for some other condition or variable of greater importance to stock valuations, such as a business cycle recovery that generates higher earnings and cash flows. This is important to the analysis of the value spread, since value stocks tend to be more cyclically sensitive than growth stocks. If it turns out that rates act more like a signal or proxy than a direct valuation driver, then it is possible that rate increases in a stagflation environment would not correlate as strongly with equity price movements as would rate increases related to a truly robust economic rebound. Indeed, interest rate cycles and business cycles often rhyme, but they also can diverge, thereby raising confusing implications for the value spread.

Perhaps because of one or more of these problems, it turns out that the empirical data does not appear nearly as compelling as the theory. Repeated academic research and empirical analysis have shown that the impact of interest rates on the relative performance of value stocks is very weak and, to the extent such an impact has been found statistically significant, it has not been remotely a dominant explanatory factor.[8]

For these reasons, we prefer to employ interest rate analysis at the level of the firm and sector, recognizing that when a sector such as financial services is disproportionately represented within value names, a steepening yield curve will almost certainly improve the group's prospects and thus generate relative outperformance versus growth names. However, to generalize the impact of rate movements over a much longer time frame, including periods when banks or other asset-sensitive financial stocks are excluded from the value opportunity set, would seem an unsupportable position to take in light of the empirical research available.

Misconception No. 5
The Crowd Has Competed Away Value's Alpha

Finally, we have come across articles speculating that the reason for the persistent underperformance of value investors over the last decade or more relates to the idea that everyone now understands the value of value investing, and so investors have crowded into the strategy, competing away the excess returns of this investment style.[9] At first glance, this argument might appear to have some merit, considering that value is a strategy that nearly every investor knows about, and so it would be hard to believe that one could make money from a game plan shared with everyone. Indeed, isn't this why successful hedge funds such as Renaissance Technologies are scrupulously secretive about the algorithms behind their alpha-rich trading operations?

Yet the argument fails for several different reasons. First, it is empirically untrue that the recent and sizable expansion in the value spread is correlated with overcrowding in value names. Quite the contrary, the last decade has seen a shift in investor funds from value to growth stocks, and a nearly consistent overweight to the megacap growth names by retail investors and an analogous overweighting of technology names by institutional investors. *(Figures 22 and 23)*[10]

Global Technology: Net % of Fund Managers Who Say They Are Overweight Technology

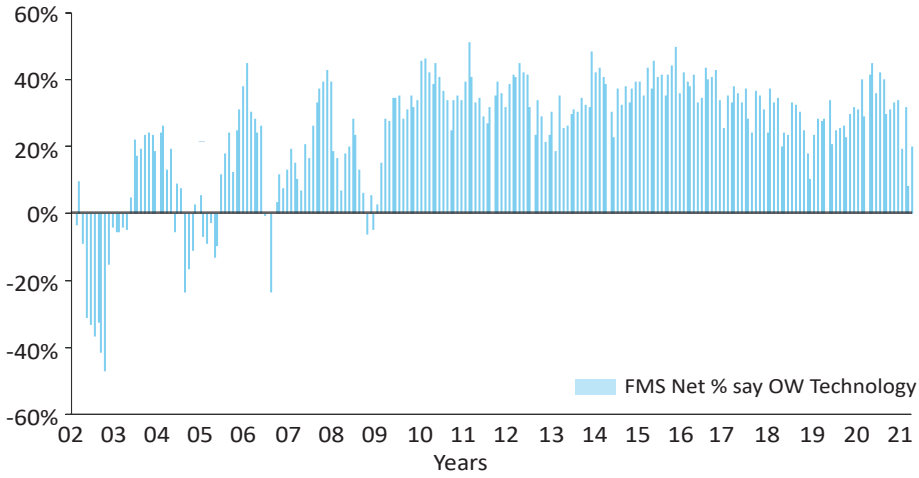

Figure 22
Net 32% of Fund Managers Say They Are Overweight Technology in the Most Recent Survey, February 5-11, 2021
Source: Bank of America Global Fund Manager Survey, February 16, 2021

Growth and Value: Valuations and Positioning

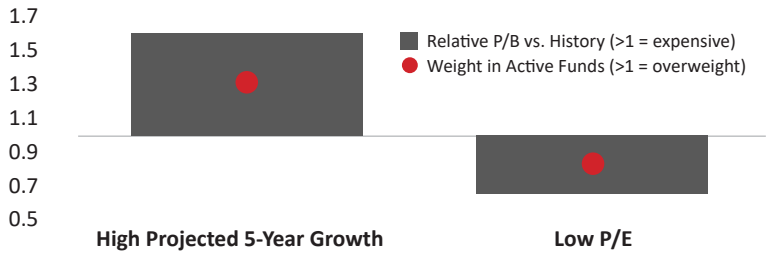

Figure 23
Active Funds Are Overweight High Expected Growth and Underweight Lower P/E Ratio
Source: Bank of America Global Research, February 10, 2021. Data as of January 31, 2021.

Moreover, the tidal wave into passive investing, which is largely tied to the largest stock indexes such as the S&P 500, Nasdaq Composite and Nasdaq 100, has prompted investors to continue purchasing more rather than fewer of those growth names as those shares rise in value, since passive investors actually prompt the purchasing of disproportionately more of past leaders and fewer of past laggards. This behavioral loop confers more momentum to leading stocks and instills proclivity for the market to overshoot in their favor.[11]

Another contributor to overcrowding into higher-priced stocks has been the emergence of ESG (environment-social-governance) investing. Mounting social and regulatory pressure to favor companies with higher ESG scores tends to reward companies that are already more expensive, perhaps adding to the momentum behind these names. *(Figure 24)* Because ESG investors tend to favor growth over value names, the increasing popularity of ESG funds and ratings has likely led to an underweight of value stocks by investors.[12]

ESG and P/E Ratios

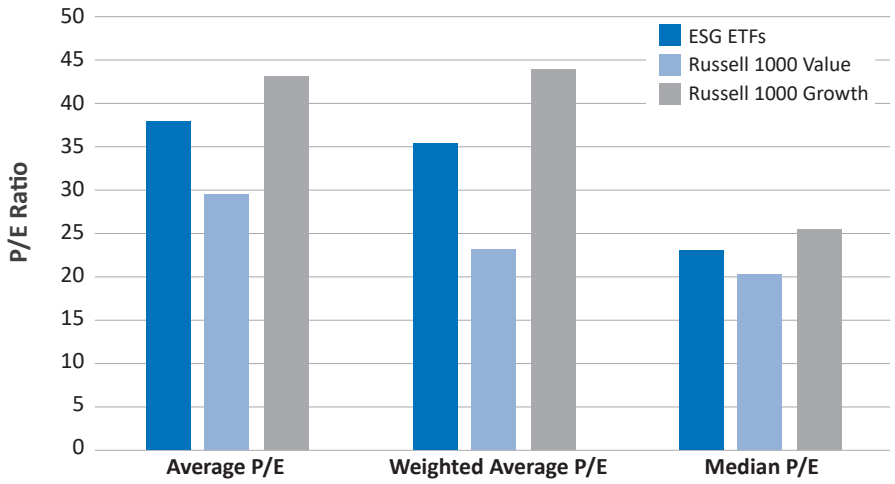

Figure 24
Stocks With High ESG Scores Tend to Trade at High P/E Ratios
Source: FactorResearch; Aswath Damodaran, Stern School of Business, New York University

Finally, it is important to understand that value investing is well-known because it is intellectually simple to articulate. That simplicity in theory, however, is deceptive in practice. The challenge in implementing value as an investing strategy is not intellectual but emotional. Value investing requires one to make unpopular or contrarian decisions, and to stand outside the crowd. This can cause practitioners to feel foolish for quite some time while the crowd rides popular momentum stocks. This creates a psychic pain that ultimately overwhelms the would-be value investors' reason, and they capitulate, sometimes close to the beginning of a new period of value outperformance. Value investing requires not only a clear head but a strong stomach; most people are not hard-wired with both. It is for this reason that value investing can be widely known but scarcely followed. The last decade exemplifies this.

And so it is that value investing can be like the tortoise, which, universally known to be slow and steady, nonetheless repeatedly wins the race, but often only after the rabbit has first raced ahead and then fallen asleep. ■

Value Investing Is Dead? No, Long Live Value!

Emidio Checcone & Brian Ear | March 2021

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Mr. Checcone joined DoubleLine in 2014. He is the Portfolio Manager of the Equity Value strategy. Prior to DoubleLine, Mr. Checcone spent six years at Huber Capital Management, where he was a Principal and Portfolio Manager. Prior to that, he worked at PRIMECAP Management Co. for six years, where he was a Principal and Financial Analyst. Mr. Checcone holds a B.A. in Social Studies from Harvard College and a J.D.-MBA from Harvard Law School and the Harvard Graduate School of Business Administration. He is a CFA® charterholder.

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Footnotes

[1] In calendar year 2020, the Russell 1000 Growth Index returned 38.49%, dwarfing the 2.78% return of the Russell 1000 Value Index.

[2] For examples, see "Beyond Buffet – Does value investing still work?" The Economist, Nov. 12, 2020 https://www.economist.com/leaders/2020/11/12/does-value-investing-still-work. "'Value is dead,' but bargain-hunting investors can significantly improve their returns by implementing these 4 steps, BofA Says," Business Insider, Sept. 8, 2020 https://markets.businessinsider.com/news/stocks/stock-market-outlook-value-investing-dead-improve-returns-bofa-bargain-2020-9-1029570553. "Why Value Investing Sucks," Institutional Investor, Nov. 13, 2019 https://www.institutionalinvestor.com/article/b1j0mvcy9792vt/Why-Value-Investing-Sucks

[3] We would like to thank Cliff Asness of AQR for supplying the inspiration for this white paper via a thought piece he authored last year: "Is (Systematic) Value Investing Dead?" AQR, May 8, 2020 https://www.aqr.com/Insights/Perspectives/Is-Systematic-Value-Investing-Dead

[4] Thus, Charlie Munger recently quipped that all investing is value investing: "You're always trying to get better prospects than you're paying for." Feb. 12, 2020, Daily Journal Corp.'s shareholder meeting Q&A session. In the same vein, his longtime partner Warren Buffett wrote: "Price is what you pay, value is what you get." 2008 Berkshire Hathaway Shareholder Letter

[5] "U.S. Equity Strategy Navigator 2020: Year in Review," Credit Suisse Equity Research, Jan. 4, 2021

[6] Constituents of the telecom services sector, as composed by Standard & Poor's, includes many companies that formerly inhabited the tech sector. Three examples are Google, Facebook and Netflix.

[7] The Wall Street Journal, "The Winner-Takes-All Stock Market Rally," April 20, 2020 https://www.wsj.com/articles/the-winner-takes-all-stock-market-rally-11587374851, "Investing in a 'Winner Takes All' Economy," April 9, 2017 https://www.wsj.com/articles/investing-in-a-winner-takes-all-economy-1491790561. "'Superstars': The Dynamics of Firms, Sectors, and Cities Leading the Global Economy," McKinsey Global Institute, October 2018 https://www.mckinsey.com/~/media/mckinsey/featured%20insights/innovation/superstars%20the%20dynamics%20of%20firms%20sectors%20and%20cities%20leading%20the%20global%20economy/mgi_superstars_discussion%20paper_oct%202018-v2.pdf

[8] SSRN, "Value and Interest Rates: Are Rates to Blame for Value's Torments?" June 16, 2020 https://ssrn.com/abstract=3608155

[9] "Is Value Investing Dead? Not So Fast, Says A Recent Study," Forbes, Jan. 3, 2021 https://www.forbes.com/sites/simonmoore/2021/01/03/is-value-investing-dead-not-so-fast-says-a-recent-study/?sh=5800bb3c1cd4

[10] "Direct Retail Investors Were the Smart Money in 2020," Barclays U.S. Equity Strategy Report, Jan. 12, 2021. "The Only Reason to Be Bearish …," Bank of America Global Fund Manager Survey, Feb. 16, 2021

[11] "Tracking Biased Weights: Asset Pricing Implications of Value-Weighted Indexing," National Bureau of Economic Research, December 2020 https://www.nber.org/papers/w28253

[12] Klerk, Eugene, et. al., "Global ESG Research: What ESG Investors Buy and Sell," Credit Suisse ESG Research Report, Feb. 4, 2021

Definitions

Amortization – An accounting technique used to periodically lower the book value of a loan or intangible asset over a set period of time. In relation to a loan, amortization focuses on spreading out loan payments over time. When applied to an asset, amortization is similar to depreciation.

Depreciation – A reduction in the value of an asset with the passage of time.

Differential – As used in this paper, taking the top half minus the bottom half of stocks, ranked by expensiveness using various metrics. Please see page one, "The Value Spread: Metrics and History."

Duration – Commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) – Measure of a company's overall financial performance that is used as an alternative to net income in some circumstances.

Empirical Rule – The empirical rule, also referred to as the three-sigma rule or 68-95-99.7 rule, is a statistical rule which states that for a normal distribution, almost all observed data will fall within three standard deviations (denoted by σ) of the mean or average (denoted by μ). In particular, the empirical rule predicts that 68% of observations falls within the first standard deviation ($\mu \pm \sigma$), 95% within the first two standard deviations ($\mu \pm 2\sigma$), and 99.7% within the first three standard deviations ($\mu \pm 3\sigma$).

Enterprise Value – A measure of a company's total value, often used as a more comprehensive alternative to equity market capitalization. EV includes in its calculation the market capitalization of a company but also short-term and long-term debt as well as any cash on the company's balance sheet. Enterprise value is a popular metric used to value a company for a potential takeover.

Enterprise-Value-to-Earnings-Before-Interest-Taxes-Depreciation-and-Amortization (EV-to-EBITDA) Ratio – Enterprise multiple, also known as the EV multiple, is a ratio used to determine the value of a company. The enterprise multiple, which is enterprise value divided by earnings before interest, taxes, depreciation, and amortization (EBITDA), looks at a company the way a potential acquirer would by considering the company's debt.

Enterprise-Value-to-Free-Cash-Flow (EV-to-FCF) Ratio – Compares the total valuation of the company with its ability to generate cashflow.

Enterprise-Value-to-Operating-Cash-Flow (EV/OCF) Ratio – Enterprise Value to Operating Cash Flow

Enterprise Value-to-Operating-Cash-Flow-Minus-Depreciation-and-Amortization (EV/(OCF-D&A)) Ratio – This ratio divides Enterprise Value by Operating Cash Flow less Depreciation and Amortization.

Free Cash Flow – The cash a company produces through its operations after subtracting any outlays of cash for investment in fixed assets like property, plant, and equipment. In other words, free cash flow or FCF is the cash left over after a company has paid its operating expenses and capital expenditures

Operating Cash Flow (OCF) – A measure of the amount of cash generated by a company's normal business operations. Operating cash flow indicates whether a company can generate sufficient positive cash flow to maintain and grow its operations, otherwise, it may require external financing for capital expansion.

Price-to-Book (P/B) Ratio – Used by companies to compare a firm's market capitalization to its book value. It's calculated by dividing the company's stock price per share by its book value per share (BVPS). An asset's book value is equal to its carrying value on the balance sheet, and companies calculate it netting the asset against its accumulated depreciation.

Price-to-Earnings (P/E) Ratio – This ratio for valuing a company measures current share price relative to earnings per share (EPS). The P/E ratio is also sometimes known as the "price multiple" or the "earnings multiple." A high P/E ratio could mean that a company's stock is overvalued, or investors are expecting high growth rates in the future.

Price-to-Earnings (P/E) Next Twelve Months (NTM) – Forward price-to-earnings (forward P/E) is a version of the ratio of price-to-earnings (P/E) that uses forecasted earnings for the P/E calculation.

Price-to-Sales (P/S) Ratio – This ratio is a valuation ratio that compares a company's stock price to its revenues. It is an indicator of the value that financial markets have placed on each dollar of a company's sales or revenues.

Return on Assets (ROA) – An indicator of how profitable a company is relative to its total assets. ROA gives a manager, investor, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings. Return on assets is displayed as a percentage; the higher the ROA the better.

Russell 1000 Value Index – This index measures the performance of the large-cap value segment of the U.S. equity universe. It includes Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

Russell 1000 Growth Index – This index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

Standard Deviation – A measure of the variation or dispersion of a set of data from its mean or expected/budgeted value. A low standard deviation indicates that the data points tend to be very close to the mean, whereas a high standard deviation indicates that the data is spread out over a large range of values. A measure of an investment's volatility. For 2 Standard Deviation, please see "Empirical Rule."

S&P 500 Index – This unmanaged capitalization-weighted index of the stocks of the 500 largest publicly traded U.S. companies is designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks, which represent all major industries.

Trailing Price-to-Earning (P/E) Ratio – A relative valuation multiple that is based on the last 12 months of actual earnings. It is calculated by taking the current stock price and dividing it by the trailing earnings per share (EPS) for the past 12 months.

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