

# Reversion to the Mean or to the Trend?

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After dramatic risk aversion in the early spring with record money market inflows and implied volatility readings, investors are now considering becoming more aggressive and trying to buy the more economically sensitive laggard stocks in the Value category. Their reasoning is: won't there be a reversion to the mean?

We think unfortunately some of these investors will be disappointed. Is it possible that Value stocks outperform off the bottom for a limited period of time? Of course, but that's a trade not an investment. Our expectation would be that the long-term trend of Growth outperformance remains in place because it has powerful structural forces driving it.

For decades, large equity benchmark providers have used price-to-book ratios to distinguish Value stocks from Growth stocks. However, businesses have been increasingly investing in intangible assets, such as research and development in new software or drugs, training and human capital, or brand building, all of which are expensed as incurred, not capitalized.

The result? Book value is now missing a large proportion of the assets of a firm and price-to-book value has produced dismal results for more than a decade.

We believe that this pandemic has accelerated the digital transformation that businesses and consumers are undertaking and as a result has hastened the rate of investment in intangible assets, further reinforcing the Growth vs. Value performance trend. From e-commerce to cloud computing and telemedicine to genetic testing and manipulation, the trends that have been in place have only been supported by the pandemic. In fact, the CEO of Alphabet, Google's parent company, commented recently that companies are "thinking deeper about the shift to digital."

History suggests that the companies most directly impacted by a crisis are not the ones to lead the stock market in the eventual recovery. For example, while Financials briefly bounced off the bottom of the Global Financial Crisis, the sector generally underperformed for the next several years, from the fall of 2009 through 2015. Our view is that those industries at the heart of this pandemic crisis, such as Value groups like brick and mortar retail, airlines and hotels are also unlikely to lead the market higher over the next several years.

So who will win the style war—Growth or Value? Calling the winner of any particular battle may be difficult, but the outcome of the war may already be decided—call it a return to the trend.



## DISCLOSURE

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