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Market Ethos

The latest market insights from Richardson Wealth

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RICHARDSON Wealth

Style Post-Mortem: Learnings from 2022

In 2022, we had a positive opinion and tilted towards the value/dividend factor among equity holdings in our multi-asset model portfolios and, subsequently, a rather negative opinion on the growth factor. That worked out really, really well, adding a good amount of alpha compared to peers. But then, in late 2022 and so far into 2023, the growth factor has returned to dominance. While we have kept up with our peer group thanks to some other contributors such as Japan and an overall overweight in international equity and manager selection within fixed income, our style tilt has been, well, wrong so far in 2023.

A post-mortem is what it sounds like, except it's your portfolio being analyzed. It is an exploratory process to dive deep into previous portfolio decisions, now with the benefit of hindsight into what happened in the markets and the performance of the portfolio. In this case, what drove our value/dividend tilt in 2022 proved correct. And why haven't we pivoted back to more growth so far in 2023? The objective is to learn from past mistakes and correct decisions to aid in future decision-making.

We hope you find this insightful, not just for your portfolio process, but for diving into any past decisions, whether they be investing, personal or business.

"We do not learn from experience…
we learn from reflecting on experience."
– John Dewey.

Why we were negative on the growth factor in 2022

Tilting away from growth and more towards value/dividends worked out smashingly in 2022. Almost all the stars were aligned in favour of value over growth at the start of that year. Measuring various equity style indices, growth really outperformed value in the 2010s, and this accelerated in 2020/21 with the pandemic-induced spending patterns. At the start of 2022, growth indices experienced about double the performance of comparable value indices during the past three years. So, let's say the performance was certainly stretched.

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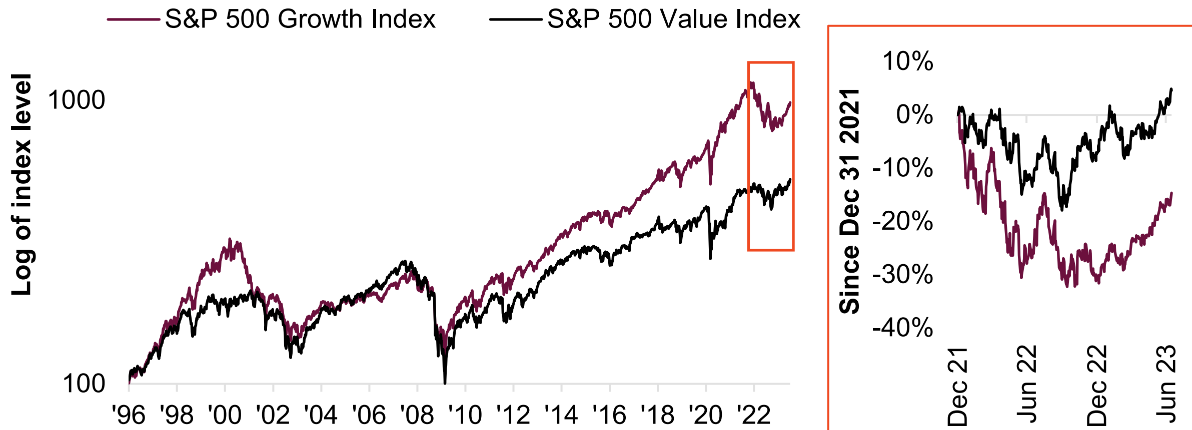
Growth vs Value - After a decade of dominance, more variability of late



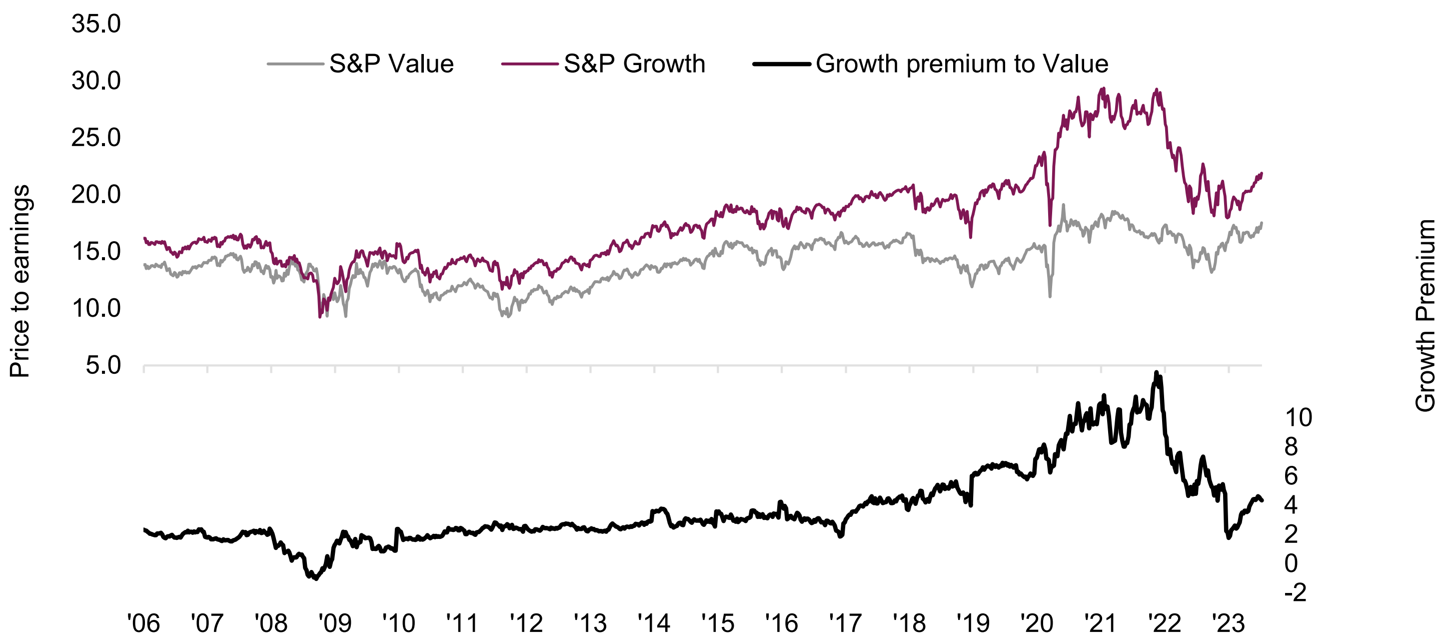
Source: Bloomberg, Purpose Investments

Valuations

In fact, to say the valuations of growth indices were stretched at the beginning of 2022 would be an understatement. The average PE ratio across the S&P 500 Growth, Russell Growth and Bloomberg Global Growth sat at 33x. The average index percentile ranking based on their historical valuations was 95th – really close to the top. This was similar across other metrics, including price-to-book and price-to-sales.

Value factor index valuations were not cheap based on their respective histories, as the markets, in general, were more expensive. But they were nowhere near as stretched as you can see in the chart below.

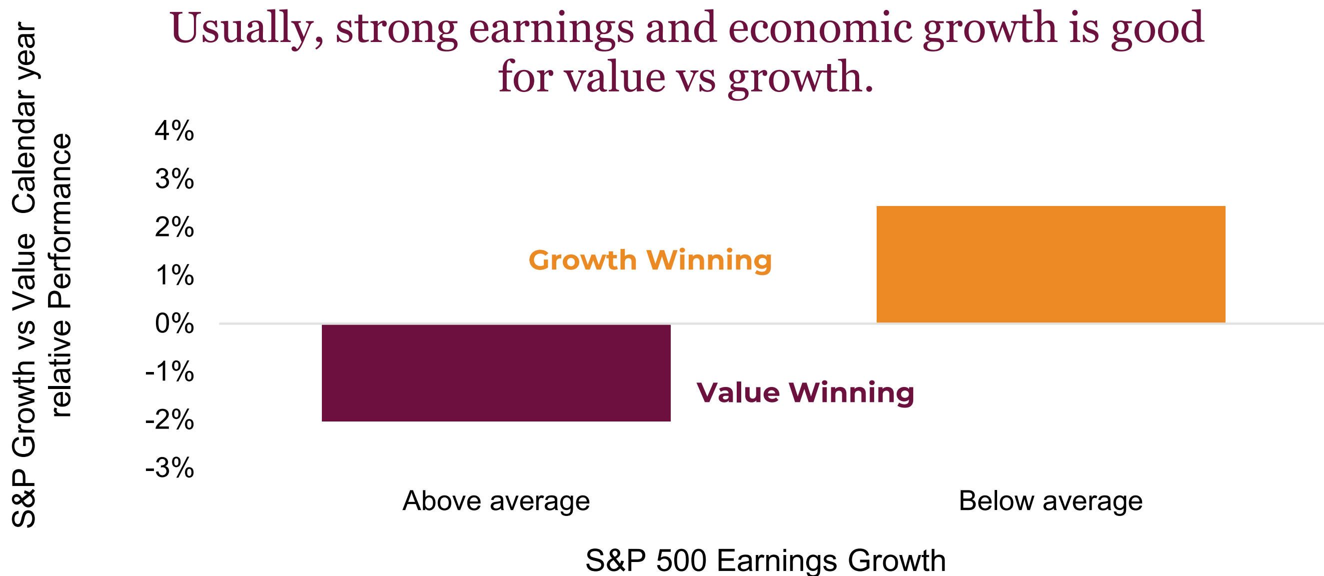
Relative Valuations were really stretched at the onset of 2022



Source: Bloomberg, Purpose Investments

Earnings growth

There is a long historical relationship between earnings growth and relative style performance. Generally, when earnings growth is strong, value outperforms growth. There are a few intuitive factors behind this; earnings growth is more abundant when the economy is doing well, and the value factor has a greater representation in many economically sensitive sectors. Meanwhile, when earnings growth is scarce, growth tends to do better. This is also a scarcity issue because when growth is hard to find, those companies that can still grow often fetch a premium.



Source: Bloomberg, Purpose Investments, calendar year periods 1975-2023

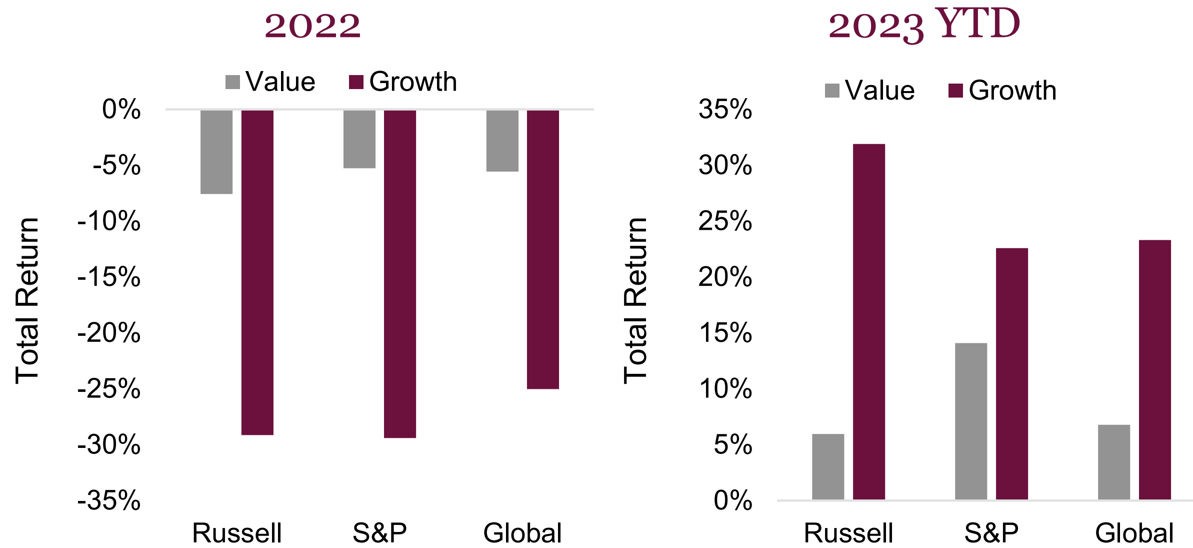
So, at the beginning of 2022, what did earnings look like? Earnings growth looked pretty good. For the S&P 500, estimates sat at $209 for 2021, growing to $223 in 2022 and $241 in 2023 – Solid high single-digit growth. This favoured value over growth.

Yields

When yields rise, as measured by the 10-year U.S. Treasury yield, value tends to outperform growth, and vice versa. This is driven by a couple of factors. Higher yields are more common when economic growth is accelerating, which makes earnings growth more abundant to favour value. Plus, growth companies tend to be viewed as longer duration based on future cash flows that are often much further in the future compared to value companies. Lower yields make the present value of those more distant cash flows worth more, favouring growth.

So, at the beginning of 2022, yields had started to come off the troughs caused by the pandemic and subsequent monetary stimulus. But the path was clearly higher in 2022, which favoured value.

Putting this all together, performance, relative valuations, earnings growth and the trajectory of yields all favoured value over growth as 2022 got going. A value tilt was both an easy decision and the right decision.



But then something changed in 2023

Value's outperformance in 2022 has certainly reversed in 2023 so far. So how did the above metrics stack up on January 1 of this year? Perhaps the strong run by value was simply due for a reversal, given the magnitude of the move. But other factors also lined up better for growth or at least much less of a headwind.

Valuations

Based on the S&P 500 style indices, the valuation spread between value and growth, which was at historic extremes at the beginning of 2022, had narrowed considerably. In January 2022, growth traded with a 10-point premium to value. A year later, in January of '23, this had narrowed to less than a 2-point premium. Growth has traded on occasion with a lower valuation than value but very rarely. So, it's safe to say a mere 2-point premium for growth was a check mark favouring growth over value [see previous chart on style valuations above].

Earnings growth

Earnings growth, which was abundant in 2022, gradually declined. Recall there was high single-digit earnings growth in January 2022, a 7% earnings growth forecast for the coming year compared to the previous. As estimates declined during the year, earnings growth expectations did as well, down to 2% earnings growth in January 2023. Once again, this lower earnings growth environment favoured growth over value.

Yields

It doesn't seem to be the absolute level of yields that matters; it is the change in yields that seems to correlate most with relative equity-style performance. 2022 saw yields rise materially, from 1.5% to 3.9%. This was good for value. So far in 2023, yields have moved around a bit but have been largely stable, sitting at 3.8% today. This may not favour growth, but it clearly isn't the headwind compared to 2022.

At the onset of 2023, it may not have been a slam dunk that growth would outperform value, but it was a materially better environment for growth compared to the previous year.

Final thoughts

Whoops, we should have clearly pivoted back to from value to growth at the beginning of 2023, hindsight being 20/20 and all. Maybe it was overconfidence fed by being so well positioned in 2022 that had us believe there was more room to run for value. Regardless, the setup in early 2023 clearly favoured growth or at least a more neutral style stance.

This, of course, raises the more important question, what about the second half of 2023 and beyond? In the table below, we have summarized our signals/methodologies for style tilts, including the readings in January 2022, 2023 and in July 2023.

	January 2022	January 2023	July 2023
Recent Performance	Value – following such strong growth outperformance, value was due	Growth – following such strong value outperformance, growth was due	Value – the size and speed of growth's rebound once again likely favours value
Valuations	Value – historically high premium of growth over value	Growth – the premium shrank from 10 to 2 points, making growth relatively cheap	Value – Nowhere near the spreads of Jan '22, but certainly, growth is trading at an above-average premium to value
Earnings Growth	Value – earnings growth was abundant	Growth – on recession concerns, earnings growth has slowed	Maybe Value – earnings growth is forecast to begin improving, but this could change if a recession develops (that would be good for growth)
Yields	Value – yields had started to rise, and the trend was upward	Neither – yields appear to have stabilized	Maybe Growth – this one is tough. If you believe a recession is coming, then yields will fall, which is good for growth if inflation remains, good for value.

Source: Purpose Investments

We would not chase this growth performance run as too many of the signals are now favouring value once again. The lesson of this post-mortem is to really develop and trust your process and don't be afraid to pivot. If you sit on a great trade for too long, it can become less of a good trade.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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