

SYMMETRY PERSPECTIVE: THE CONUNDRUM OF VALUE

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“Eventually his patience will be rewarded, but it may be subjected to a severe strain by the vagaries of speculative sentiment.”

- Philip L. Carret
The Art of Speculation (1930)



Warren Buffett once said of one of his role models, famed Value investor Phil Carret, that he had “the best long term investment record of anyone I know,” referring to his 55-year run as portfolio manager of one of the first mutual funds in the United States, during which an investment of \$10,000 became \$8 million. Like Buffett, Carret strongly believed in valuation as an important metric for long term investing success. These early pioneers were able, by way of intuition and observation, to engage in a disciplined methodology that has come to be called “Value investing.”

The price of securities, at their core, reflect the expectations for the future cash flows those assets will generate. The challenge of arriving at a current price is:

1. The inherent uncertainty around the estimate of those future cash flows.
2. Determining a reasonable reward for assuming the risk of being wrong in that assessment.

The risk of being wrong is higher for securities of companies viewed as having lower profitability and earnings, or a higher degree of financial distress or risk of default.

“Value investing” is basically the discipline of paying a lower price for the future cash flows of these types of companies, to help offset the potential higher risk of a wrong estimate of current price (i.e. a “margin of safety”).

Decades after Carret helped popularize the concept, academics would produce a vast body of work with evidence of a “Value premium” demonstrated by securities over time, validating his intuition with data. Since then, the discipline of Value investing has become widely adopted.

Is Value Disappearing?

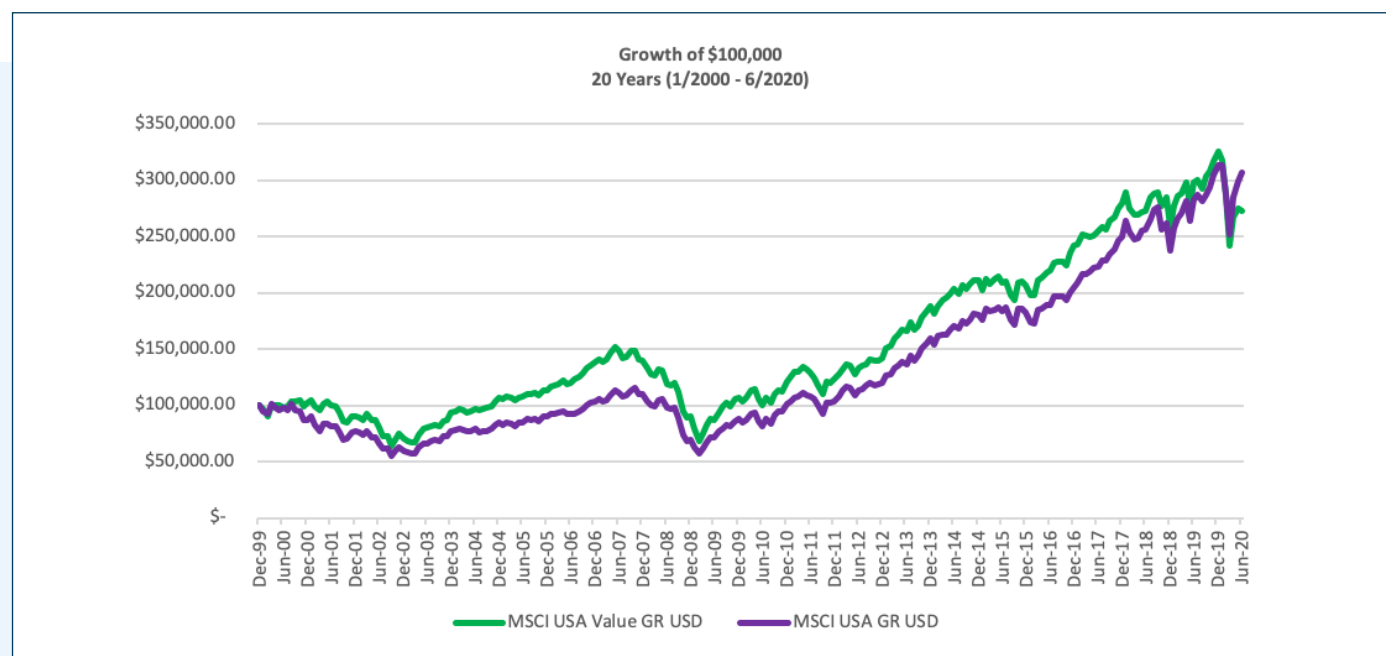
Over the last nine decades, Value investors have been rewarded for the approach, as the “Value premium” has been positive on average. However, it has not been immune to periods of underperformance, and investors have recently experienced a long and discouraging period of pronounced underperformance, causing many to question if the strategy is still relevant.

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For example, as you can see from the following chart, an investment in US Value would have outpaced the broader US market for the majority of the past twenty years, with the market catching up to, then outperforming, in the past few years.

US Value vs US Markets Jan 2000 – June 2020



Source: Morningstar Direct. Please see disclosure in the back for additional information. Hypothetical Illustration. Investors cannot invest directly in an index. Indexes have no fees.

While the historic data is informative, does the depth of the recent drought suggest a fundamental regime shift in the underlying economics such that the expectations of some reversion to the mean is misplaced? In short, has the Value factor somehow disappeared?

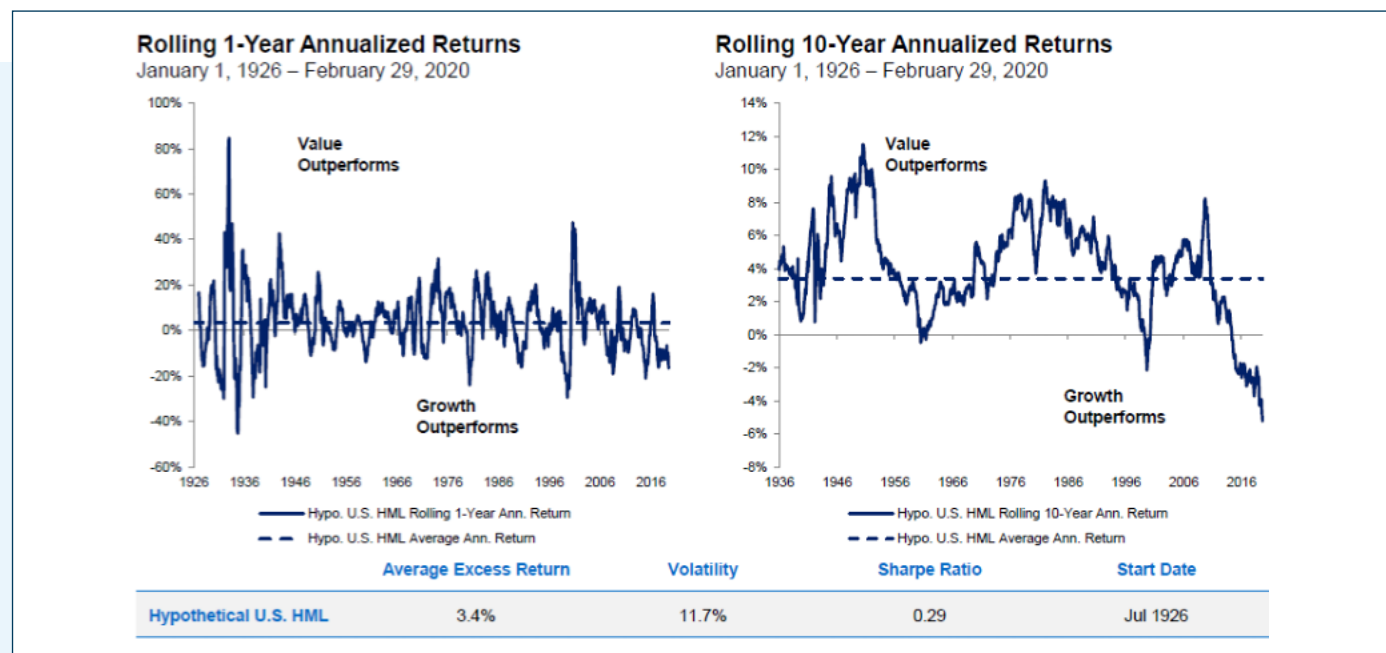
Professors Fama and French recently revisited their groundbreaking 1992 research identifying the Value premium in a paper published January 2020. Their conclusion: Value premiums — defined as returns in excess of the market — were on average “much lower” than the those originally observed in their previous work; however, there was too much volatility in monthly returns to decisively determine whether or not the expected premium from the factor has changed. Their findings suggest that the data to-date simply does not provide a definitive answer one way or the other.

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Value vs. Growth

Perhaps another way to approach the question is to look not at returns in **excess** of market, but to look at returns **relative** to other characteristics or styles such as “growth,” to see if there is any evidence that Value holds up better than Growth.

Value Minus Growth US Markets Jan 1926 – Feb 2020



Source: AQR, Bloomberg. Average excess return is the arithmetic, annualized return of the self-financing long/short HML factor. Sharpe Ratio is calculated by using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe Ratio, the better the fund's annualized excess returns. Standard Deviation is a measure of the risk of an investment that measures the dispersion of returns around the average return. The higher the standard deviation, the more volatile, or “risky” the investment has been based on historical returns. Time period based on availability of data. All information is for educational and illustrative purposes. All returns are gross of fees and transaction costs. No representation is being made that any investment will achieve performance like that shown. Past performance is not a guarantee of future performance. performance. Please see important disclosure in back to fully understand hypothetical data being shown in this chart.

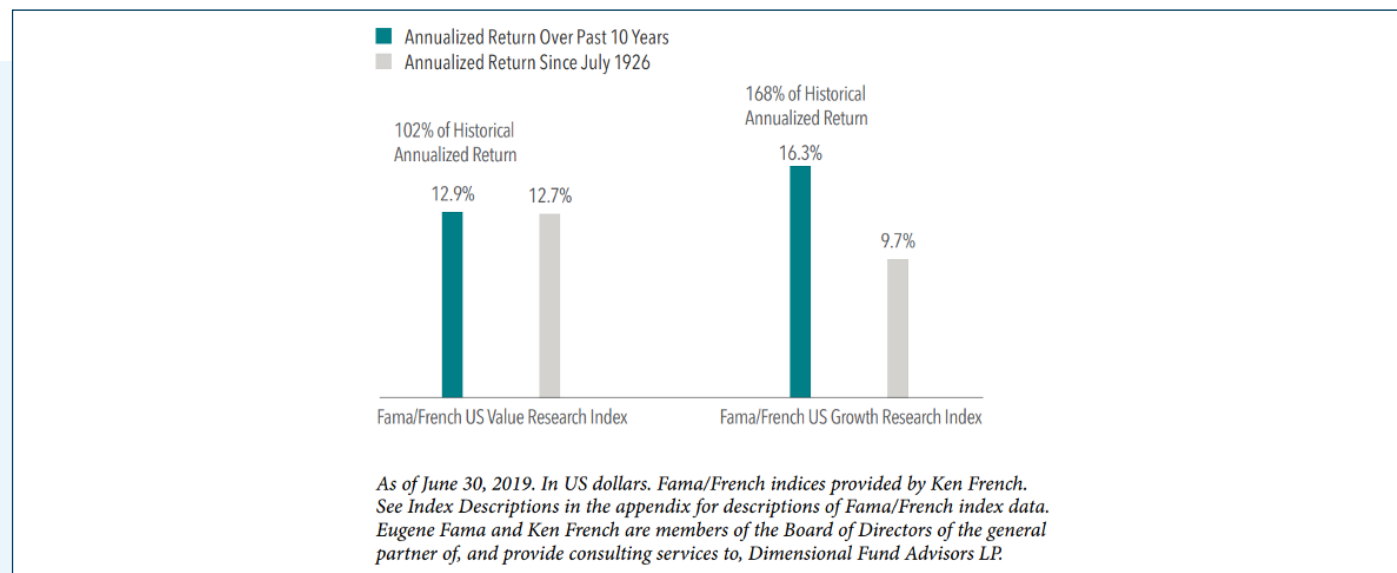
Using the charts above to review of both short- and long-term rolling periods of Value performance relative to Growth, we can see that, as with performance in excess of market, Value is prone to periods of underperformance, but on average, does deliver a positive return. However, in recent years Growth has outperformed its long-term averages significantly.

Comparing the returns for the US Value and Growth indices separately in the chart on the next page, we see that Growth's annualized compound return of 16.3% over the 10-year period ending June 2019 was much higher than its return since July 1926, at 9.7%. While performance of Value has been fairly consistent over the same period: 12.9% vs. 12.7%. It is therefore Growth, not Value that has demonstrated unusual returns relative to the long-term historical average.

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US Value vs US Growth over the past 10 years and since 1926

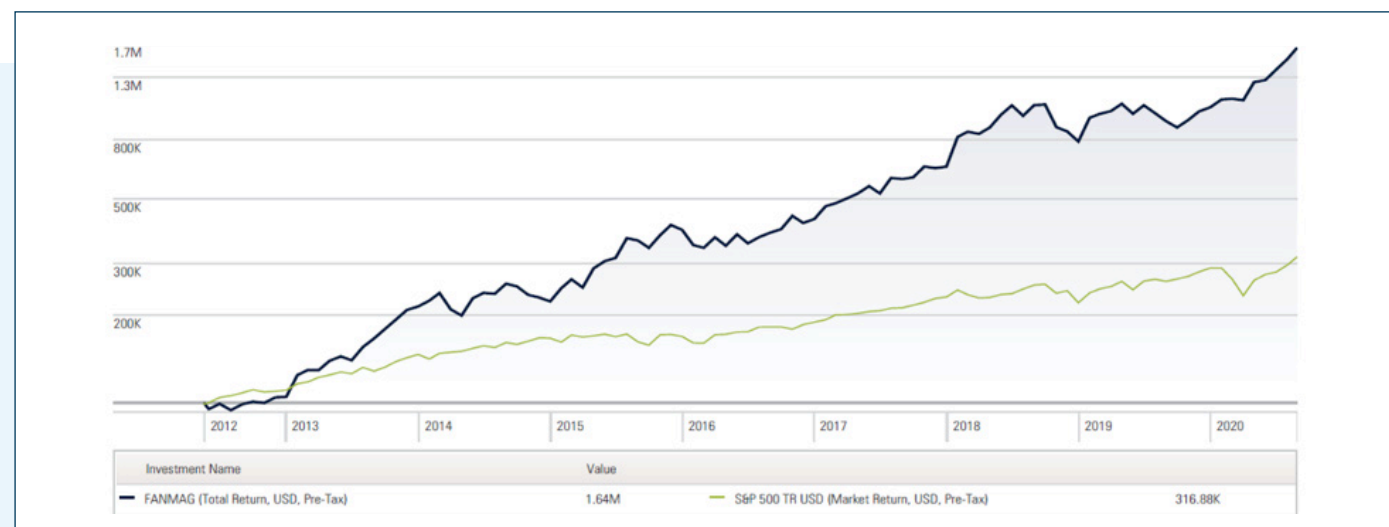


Source: Dimensional Fund Advisors. Please see important disclosure in back to fully understand hypothetical data being shown in this chart.

The unusual performance of Growth has largely been driven by a handful of stocks. Microsoft, Apple, Amazon, Alphabet/Google, Facebook now represent over 20% of the overall US market-cap, which is a historic level of concentration in a handful of names. The returns associated with the securities of this companies has been strong over the past decade, accelerating recently.

For instance, over the past eight years, as the chart below shows, a hypothetical \$100,000 invested in the FANMAG stocks (Facebook, Amazon, Netflix, Microsoft, Apple, & Google) would have significantly outpaced a similar investment in the S&P 500, \$1.64m vs \$316k.

FANMAGs vs the S&P 500 over the past 8 years



Source: Morningstar Direct. Please see disclosure in the back for additional information.

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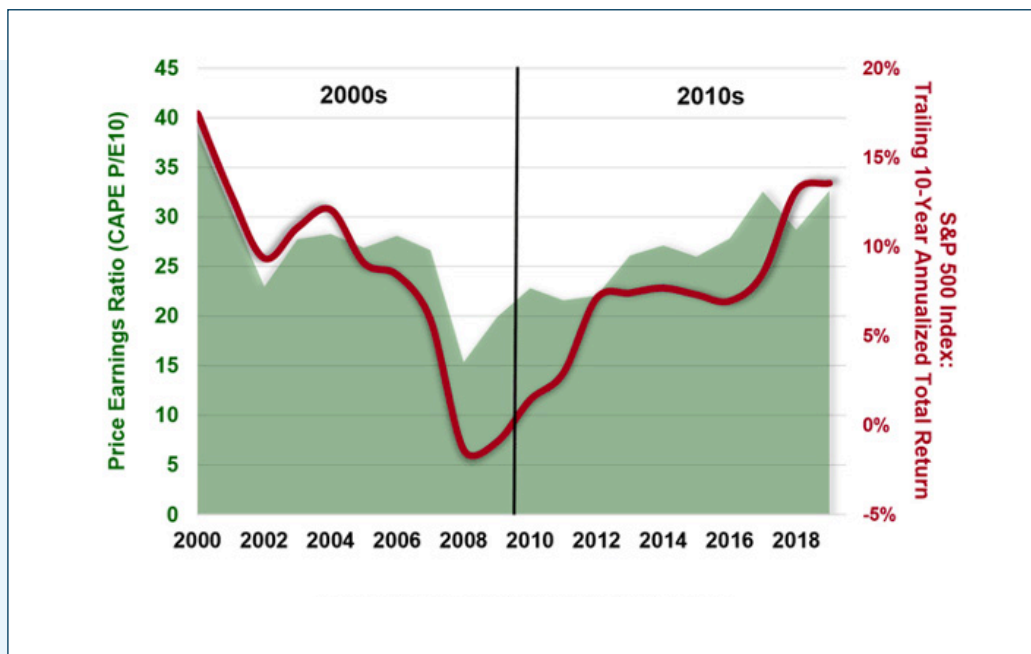
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As these handful of stocks have powered the returns of both Growth stocks, and the overall market, they have also helped drive up valuations for both into uncommon territory. Market valuations on a Shiller P/E basis are in the 95th percentile since 1881. Meaning the current market ranks right up there in terms of one of the most expensive markets of all time.

This suggests, at current valuations, the market is “priced for perfection,” meaning the market assumes virtually no uncertainty around future cash flows, and has abandoned any “margin of safety” in pricing. History shows that when the market has demonstrated similar levels of heightened valuation, future returns may be less than perfect.

The late 1990’s saw a market environment with similarly heightened valuation levels. The bursting of the “tech bubble” was a catalyst for resetting expectations on valuation of future cashflows, and what followed was a period of disappointing returns. As we can see from the chart below, the “lost decade” from January 2000 through December 2009 resulted in annualized returns of -0.95% for the S&P 500. This period of poor market performance helped to drive down overall market valuations to levels much more attractive from a “margin of safety” standpoint. More reasonable valuations helped to set the stage for significantly better returns the next decade.

Valuation Drives Returns 2000-2019



Source: Crestmont Research. Please note the data presented above shows returns for the selected time period. Investors cannot invest directly in an index. Indexes have no fees. For limitations to the performance information, please see disclosure in back.

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When Does the Music Stop?

In the 83 ten-year periods starting in 1936, Growth outperformed Value only eight times. Five of those ten-year periods ended in each of the last five years.

At some point this enthusiasm for potential future growth tips over into irrational exuberance.

While we have no crystal ball, and can't predict when Growth will give way to Value, many believe it could happen soon. A number of financial experts and Wall Street strategists have said that this year or next could in fact be the year of Value.

In the words of famed investor and former George Soros colleague, Jim Rogers, "If you buy Value, you won't lose much even if you're wrong."

All this means that investors should take another look at their portfolios and how they are invested.

Are you properly diversified...or over-allocated to Growth? Do you have sufficient tilts to factors of return such as Value (and Small and Minimum Volatility)? Are you in the right portfolios for your comfort with risk and long-term goals?

We believe there are no magic bullets—or simple answers when it comes to investing. But holding a globally-diversified portfolio and staying focused on the long-term—we believe—is one of the best ways to grow your portfolio.

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Symmetry Partners' investment approach seeks enhanced returns by overweighting assets that exhibit characteristics that tend to be in accordance with one or more "factors" identified in academic research as historically associated with higher returns. Please be advised that adding these factors may not ensure increased return over a market weighted investment and may lead to underperformance relative to the benchmark over the investor's time horizon. The factors Symmetry seeks to capture may change over time at its discretion. Currently, the major factors in equity markets used by Symmetry and some associated academic research are: the market risk premium (Sharpe, William F. "Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk." The Journal of Finance, Vol. 19, No. 3 (Sept. 1964), 425-442.), value (Fama, Eugene and Ken French. "Common risk factors in the returns on stocks and bonds." Journal of Financial Economics, 33, (1993), 3-56.), small (Banz, Rolf W. "The Relationship Between Return and Market Value of Common Stocks." Journal of Financial Economics, 9 (1981), 3-18.), profitability (Novy-Marx, Robert. "The Other Side of Value: The Cross Profitability Premium." Journal of Financial Economics, 108(1), (2013), 1-28.), quality (Asness, Clifford S.; Andrea Frazzini; and Lasse H. Pedersen. "Quality Minus Junk." Working Paper.), momentum (Jegadeesh, Narasimhan and Sheridan Titman. "Returns to Buying Winners and Selling Losers: Implications for Stock Market Efficiency." The Journal of Finance, Vol. 48, No. 1, (March 1993), 65-91), and minimum volatility (Ang, Andrew, Robert J. Hodrick, Yuhang Xing and Xiaoyan Zhang. "The Cross-Section of Volatility and Expected Returns." The Journal of Finance, Vol. 61, No. 1 (Feb. 2006), pp. 259-299.) On the bond side, Symmetry primarily seeks to capture maturity and credit risk premiums (Ilmanen, Antti. Expected Returns: An Investor's Guide to Harvesting Market Rewards. Wiley Finance, 2011, p157-158 and 183-185.).

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US Value vs. US Markets Disclosure

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MSCI USA Value Index (Value) captures large and mid cap US securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. With 315 constituents, the index targets 50% coverage of the free float-adjusted market capitalization of the MSCI USA Index.

MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 637 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

Valuation Drives Returns Disclosure

S&P 500: Represents the 500 leading U.S. companies, approximately 80% of the total U.S. market capitalization.

US Value vs. US Growth over the past 10 years (DFA)

Fama/French US Value Research Index: Provided by Fama/French from CRSP securities data. Includes the lower 30% in price-to-book of NYSE securities (plus NYSE Amex equivalents since July 1962 and Nasdaq equivalents since 1973). Actual and back-tested performance results assume the reinvestment of dividends and capital gains.

Fama/French US Growth Research Index: Provided by Fama/French from CRSP securities data. Includes the higher 30% in price-to-book of NYSE securities (plus NYSE Amex equivalents since July 1962 and Nasdaq equivalents since 1973). Actual and back-tested performance results assume the reinvestment of dividends and capital gains.

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Value minus Growth vs. Markets (AQR) Disclosure

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The results shown represent a hypothetical illustration. Hypothetical or simulated performance results assume the portfolio holding(s) were purchased on the first day of the period indicated. The hypothetical or simulated performance results are compiled with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Changes in the assumptions may have a material impact on the model presented. Other periods may have different results, including losses. There can be no assurance that the analysis will achieve profits or avoid incurring substantial losses. AQR did not manage or recommend this allocation to clients during periods shown, and no clients invested money in accounts managed by AQR in accordance with the recommended allocation. Results may vary with each use of the analysis and over time. Past performance is no guarantee of future results.

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Value Minus Growth vs. Markets Disclosure Continued

The hypothetical performance results contained herein represent the application of the quantitative models as currently in effect on the date first written above and there can be no assurance that the models will remain the same in the future or that an application of the current models in the future will produce similar results because the relevant market and economic conditions that prevailed during the hypothetical performance period will not necessarily recur. Discounting factors may be applied to reduce suspected anomalies. This backtest's return, for this period, may vary depending on the date it is run. Hypothetical performance results are presented for illustrative purposes only. In addition, our transaction cost assumptions utilized in backtests, where noted, are based on AQR Capital Management, LLC's, ("AQR")'s historical realized transaction costs and market data. Certain of the assumptions have been made for modeling purposes and are unlikely to be realized. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented. Actual advisory fees for products offering this strategy may vary. There is a risk of substantial loss associated with trading commodities, futures, options, derivatives and other financial instruments. Before trading, investors should carefully consider their financial position and risk tolerance to determine if the proposed trading style is appropriate. Investors should realize that when trading futures, commodities, options, derivatives and other financial instruments one could lose the full balance of their account. It is also possible to lose more than the initial deposit when trading derivatives or using leverage. All funds committed to such a trading strategy should be purely risk capital.

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The value factor HML follows Fama and French (1992, 1993 and 1996). HML is the average return on the two value portfolios minus the average return on the two growth portfolios. Book to market ratios are computed by scaling book equity by the total market value of equity at fiscal end. Note that for firms with fiscal year ending in December this is the same measure as Fama and French (1992). For firms with fiscal year not ending in December, we use prices at the fiscal year-end date while Fama and French (1992) use December prices for all firms.

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