

C A M B R I D G E A S S O C I A T E S L L C

EUROPEAN MARKET COMMENT: WHY HAS VALUE SO CONSISTENTLY OUTPERFORMED GROWTH?

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Why Has Value So Consistently Outperformed Growth?

In Europe, value equities have consistently outperformed growth over the last 28 years. Since 1975, the MSCI U.K. Value Index has posted an average annual cumulative return (AACR) of 17.1%, compared with 14.6% for the U.K. Growth Index (see Table A). Equal investments in these indices in 1974 would have produced an 82% larger sum for value than for growth. Similarly, MSCI Europe ex U.K. Value reported an AACR of 12.5% over this period, compared with 10.8% for the Growth Index, a cumulative disparity that yielded 56% more for value relative to growth (see Table B). (All returns represent total returns in sterling (£) unless otherwise noted.)

Although this period has witnessed leadership rotation between value and growth, value has been superior to growth over the long term, because it beat growth more often than vice-versa and because its winning stretches were longer and opened up a larger margin than have growth's periods of outperformance (see Tables C-F). The MSCI U.K. Value Index has bested its U.K. Growth Index 18 out of the last 28 years, or 64% of the time, outperforming over one seven-year and two five-year periods, while growth's two periods of outperformance lasted 2.5 years.¹

While value has also surpassed growth on the Continent, its margin of outperformance has not been as dramatic as in the United Kingdom. MSCI Europe ex U.K. Value has outperformed its growth counterpart in 15 out of 28 years, or 54% of the time, surpassing growth in one six-year, one 3.5-year and one three-year period, while growth bested value during one six-year and one 2.5-year period.² Value and growth were basically tied until February 2000 when value shot ahead at an unprecedented rate due to the implosion of telecom stocks.

If It Quacks Like a Growth Stock . . .

Part of value's outperformance can be attributed to MSCI's index calculation methodology. MSCI uses price-to-book ratios (P/B) to categorize all companies as either value or growth. Securities with the lowest 50% P/B are classified as value, while those with the highest 50% P/B are placed in the growth index. Classifying equities on the basis of this one dimension without considering other indicators—such as earnings growth, price-to-sales, cash flow, or internal growth rate—results in some idiosyncratic classifications. For example, in the past two years MSCI's European Growth Index has been heavily weighted in consumer staples, health care, energy, and financials, with technology accounting for only a modest size.

Furthermore, MSCI's methodology has generated striking differences in its U.K. and its Europe ex U.K. growth and value indices. For example, communication services comprises 19.7% of the MSCI U.K. Value Index, while the sector

¹ Value's periods of outperformance included January 1983 to March 1990, January 1975 to April 1980, October 1992 to September 1997, while growth outperformed during May 1980 to December 1982 and April 1990 to September 1992.

² Value outperformed January 1987 to December 1992, December 1980 to May 1984, March 2000 to March 2003, and growth outperformed, January 1975 to November 1980 and June 1984 to December 1986.

is roughly half value/half growth in the Europe ex U.K. indices (19.7% market weight in U.K. Value, 7.2% in Europe ex U.K. Value; 0.0% in U.K. Growth, and 9.2% in Europe ex U.K. Growth).

Value's consistent outperformance cannot be entirely attributed to MSCI's index methodology, however, for value has also bested growth among the Citigroup European style indices (formerly Salomon Smith Barney), which incorporate other measures in its index construction. Since the beginning of our Citigroup index data in July 1989, its U.K. Value and Growth indices have posted AACRs of 8.3% and 6.6%, compared with its European ex U.K. Value and Growth's AACRs of 8.2% and 6.1%. Value's margin of outperformance is therefore similar to that recorded by the MSCI indices returns of 7.6%, 6.4%, 7.5%, and 5.0%, respectively, over the same period.

Beyond Benchmark Determinism

Until recent years, equity markets in Europe had not developed sufficiently deep subsets of stocks that behaved in consistent ways to allow for their classification as either growth or value. Money managers who were not index driven tended to follow a growth-at-reasonable-price approach and were less concerned with following a growth or value discipline. Furthermore, until recently European investors have tended to seek diversification in U.S. equities, rather than in their own region. However, blurred boundaries in the past may grow more distinct in the future. The launch of the euro as a single currency and the integration of fragmented markets have begun to erode the tendency among investors to view their local bourses as singular entities requiring separate investment strategies. This evolution is fostering pan-European strategies that place increasing emphasis on diversification through style investing.

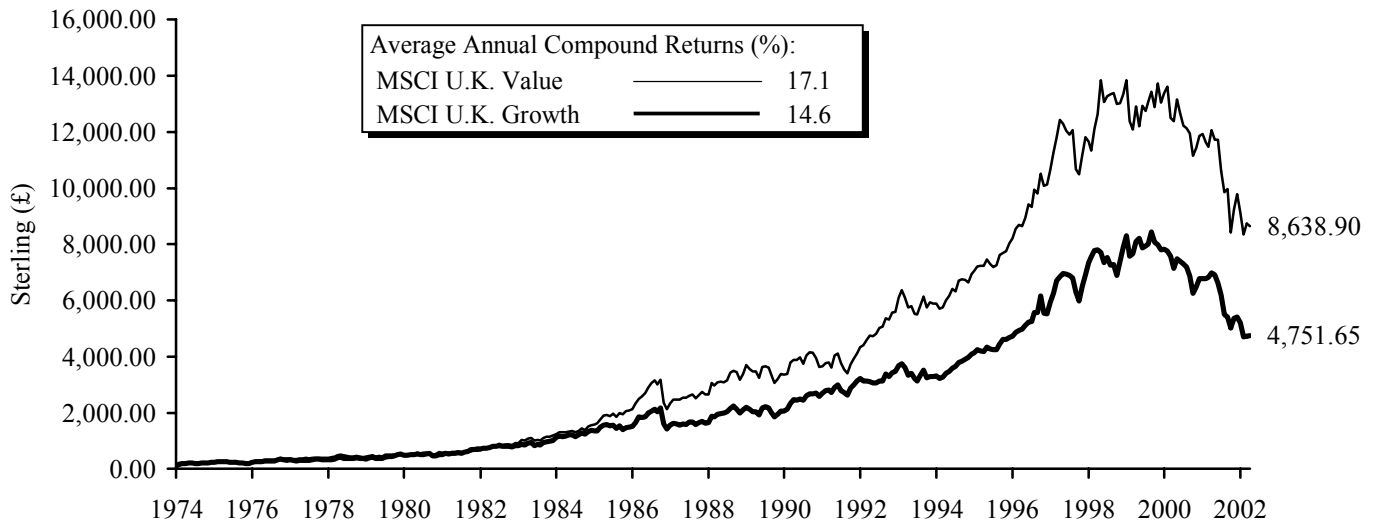
Regardless of benchmark definitions, as style acquires greater credence and acceptance in Europe, it should assume a more distinct European flavor while shedding its more U.S.-centric features. The types of "growth" sectors that drive Europe's economies are different from the "growth" that characterizes U.S. markets. While style may grow increasingly accepted for its diversification benefits, each regional value and growth index will likely retain distinctive biases and traits. This suggests that investors should seek out managers who have a differentiated and flexible approach to cross-border style investing, instead of those who pick stocks based on transplanted or preconceived notions of growth or value.

Table A

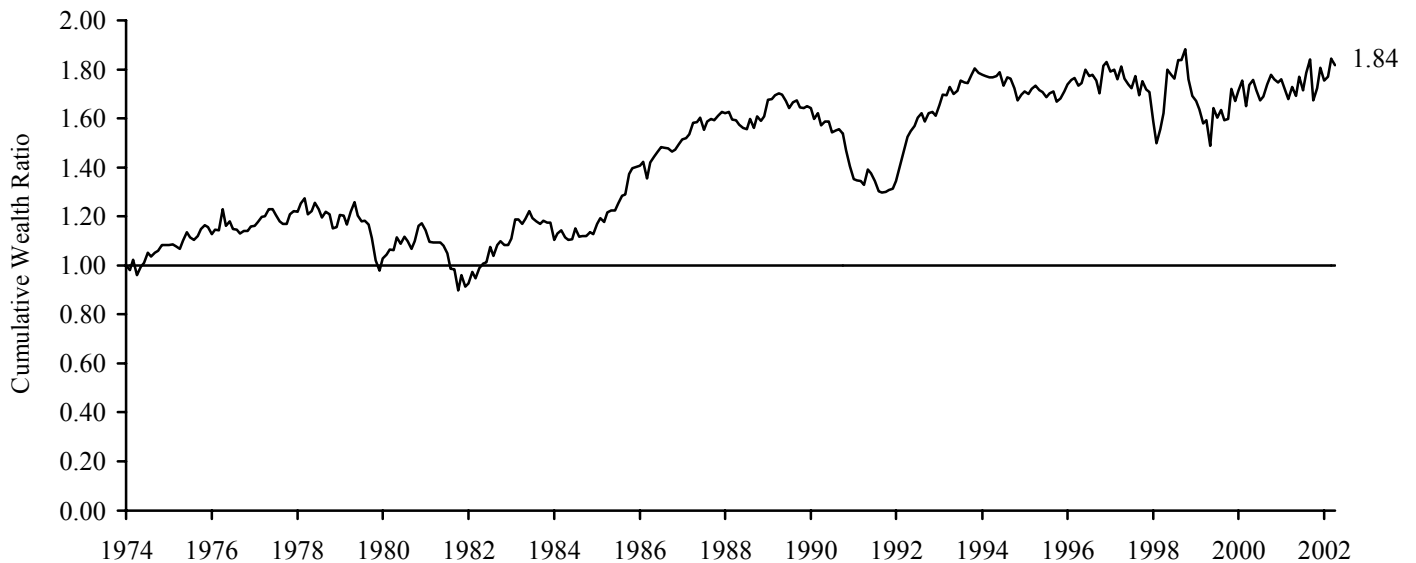
CUMULATIVE WEALTH OF THE MSCI UNITED KINGDOM VALUE AND MSCI UNITED KINGDOM GROWTH INDICES

1 January 1975 - 31 March 2003

**Cumulative Wealth Index
(31 December 1974 = £100)**



**Relative Cumulative Wealth Index
(MSCI U.K. Value/MSCI U.K. Growth)**



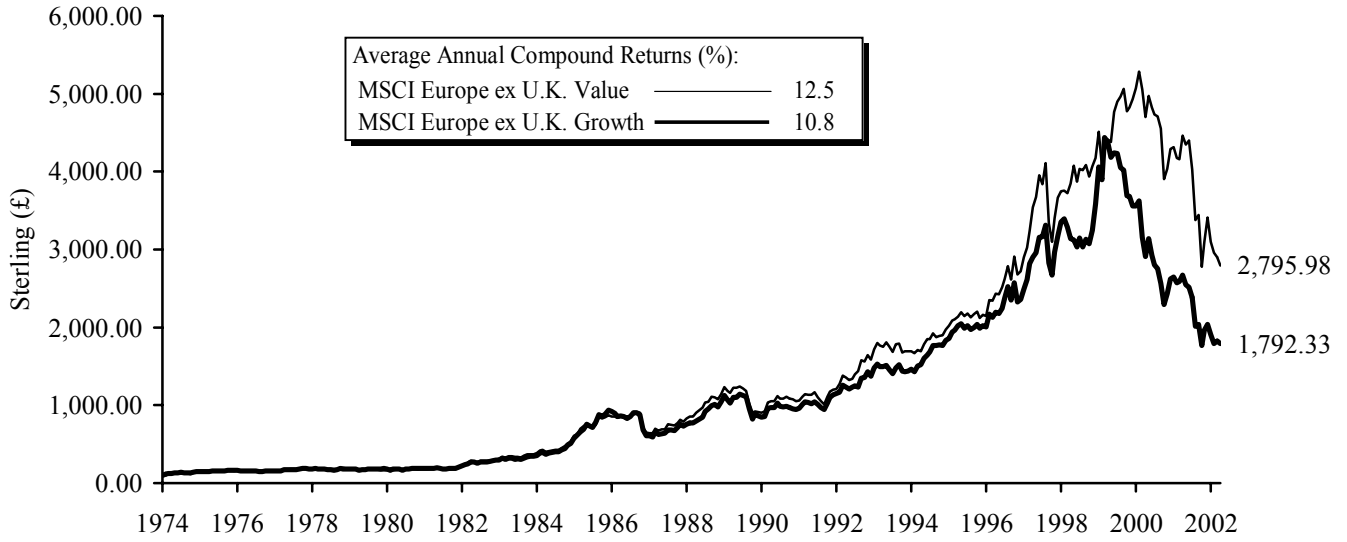
Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Table B

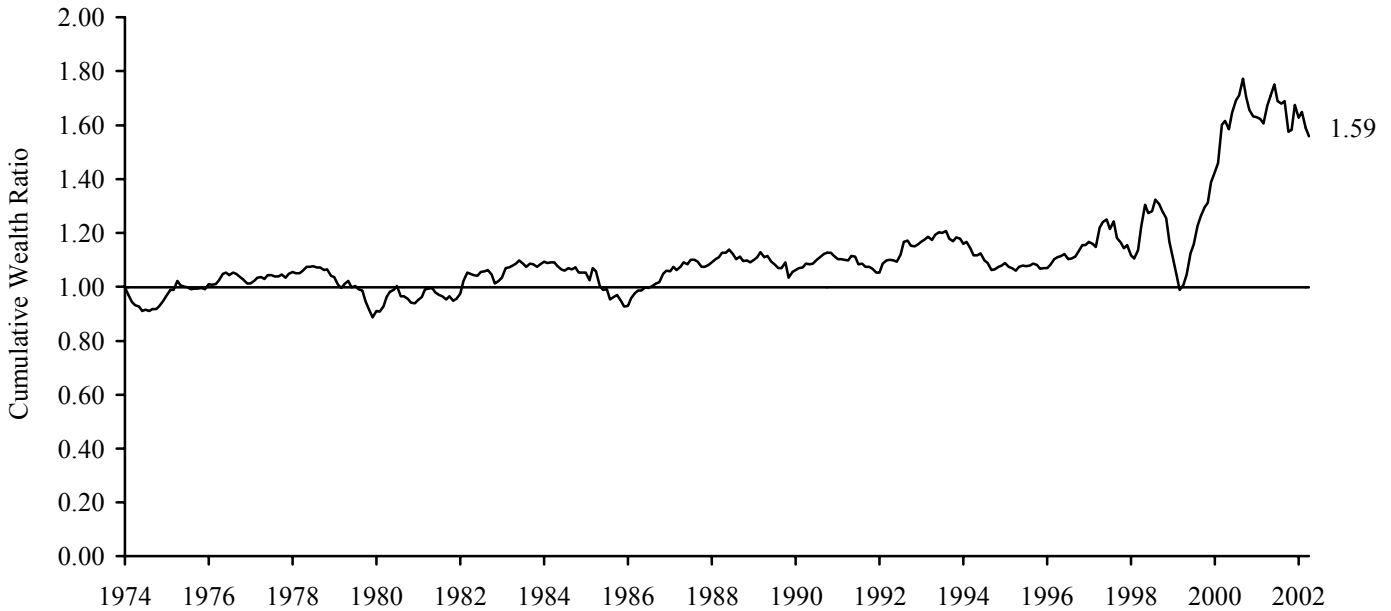
CUMULATIVE WEALTH OF THE MSCI EUROPE EX U.K. VALUE AND MSCI EUROPE EX U.K. GROWTH INDICES

1 January 1975 - 31 March 2003

**Cumulative Wealth Index
(31 December 1974 = £100)**



**Relative Cumulative Wealth Index
(MSCI Europe ex U.K. Value/MSCI Europe ex U.K. Growth)**



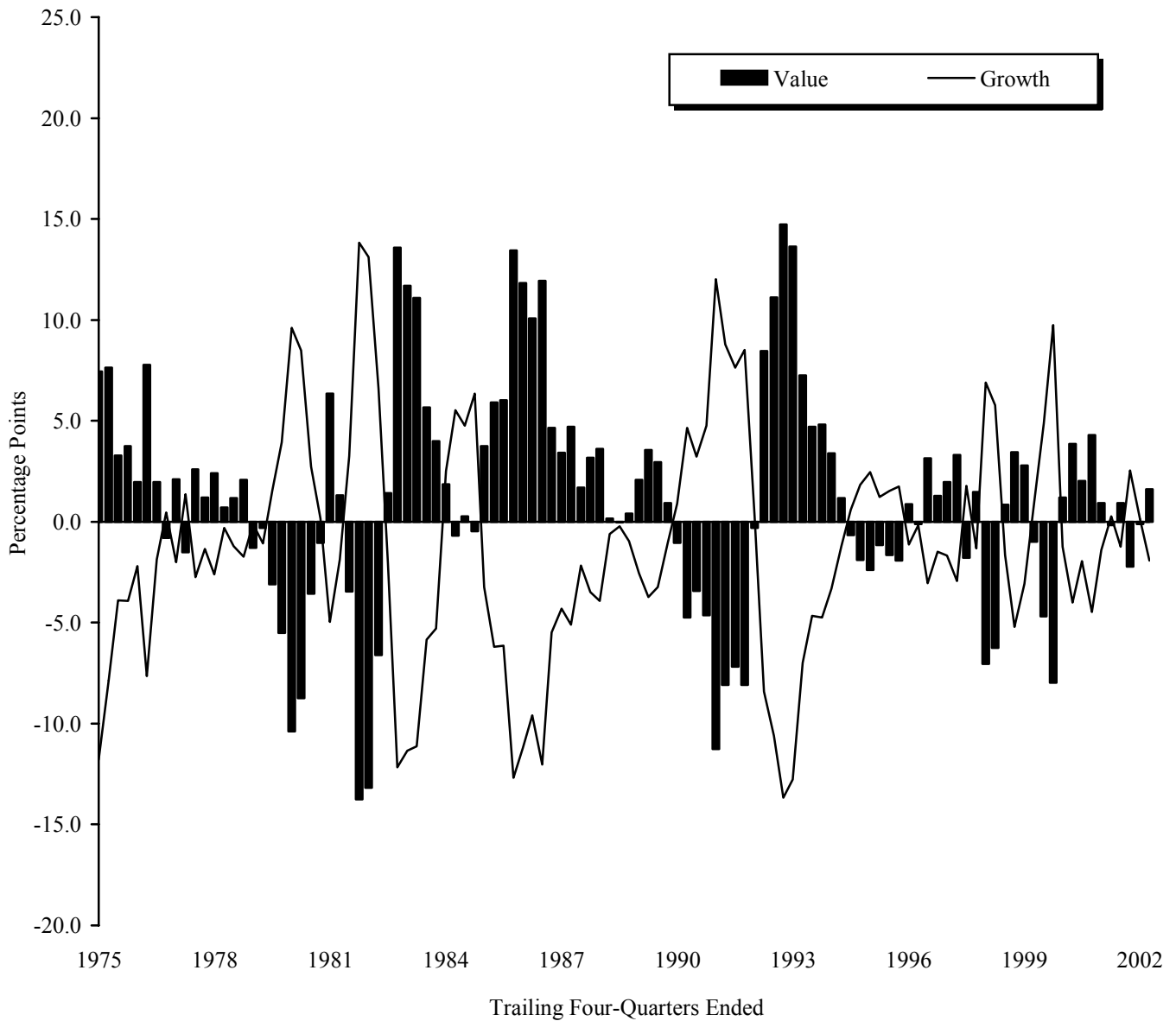
Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Table C

**MSCI UNITED KINGDOM GROWTH AND VALUE INDEX RETURNS RELATIVE TO
MSCI UNITED KINGDOM**

1 January 1975 - 31 March 2003

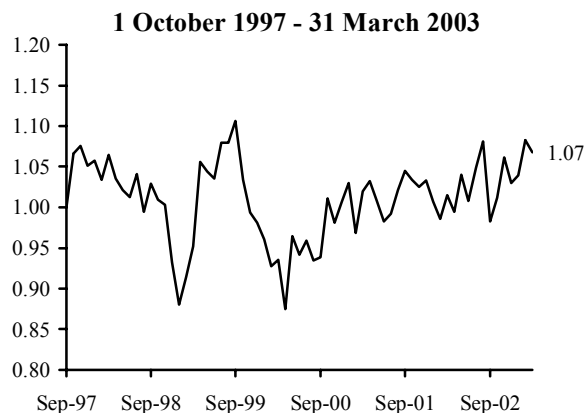
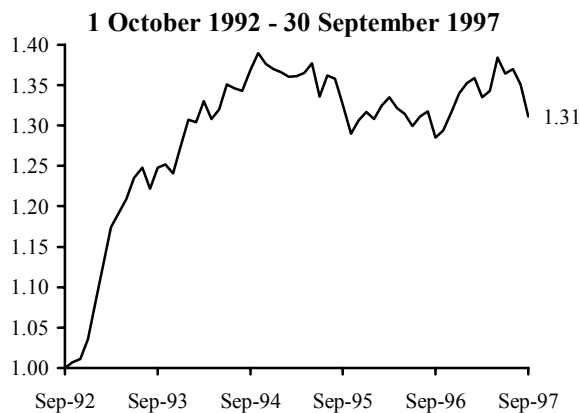
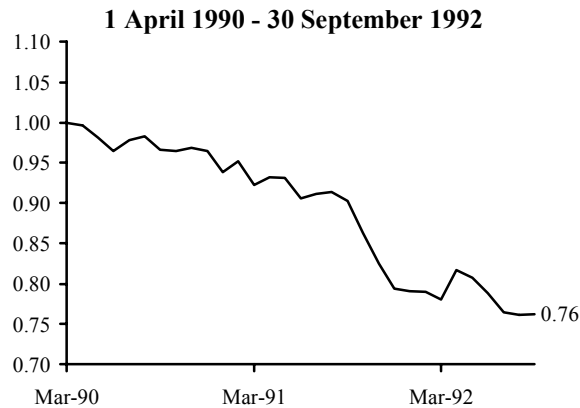
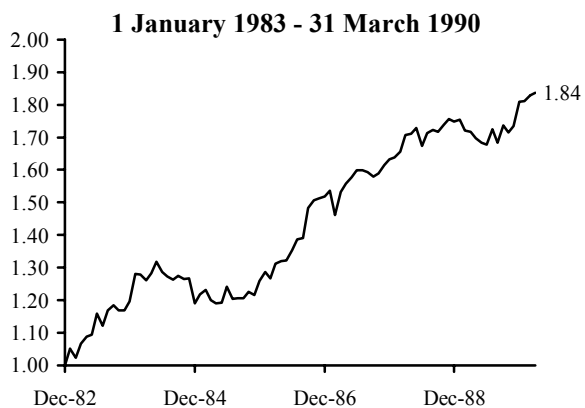
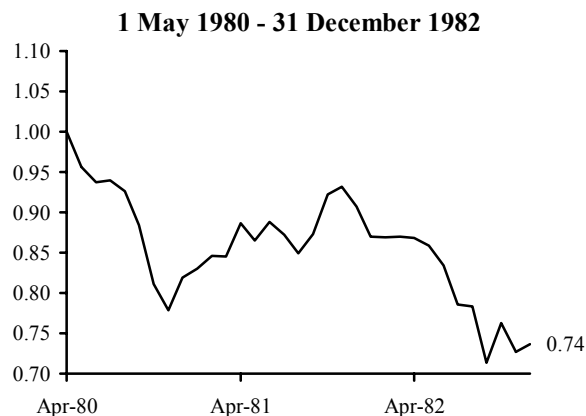
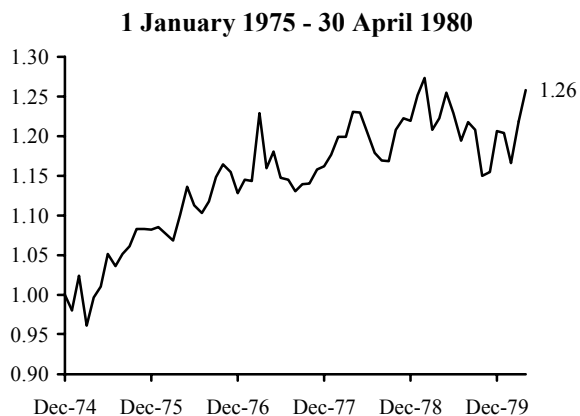
Differential
Above/Below
MSCI United
Kingdom Index



Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Table D

MSCI UNITED KINGDOM VALUE RELATIVE TO MSCI UNITED KINGDOM GROWTH OVER DIFFERENT PERIODS



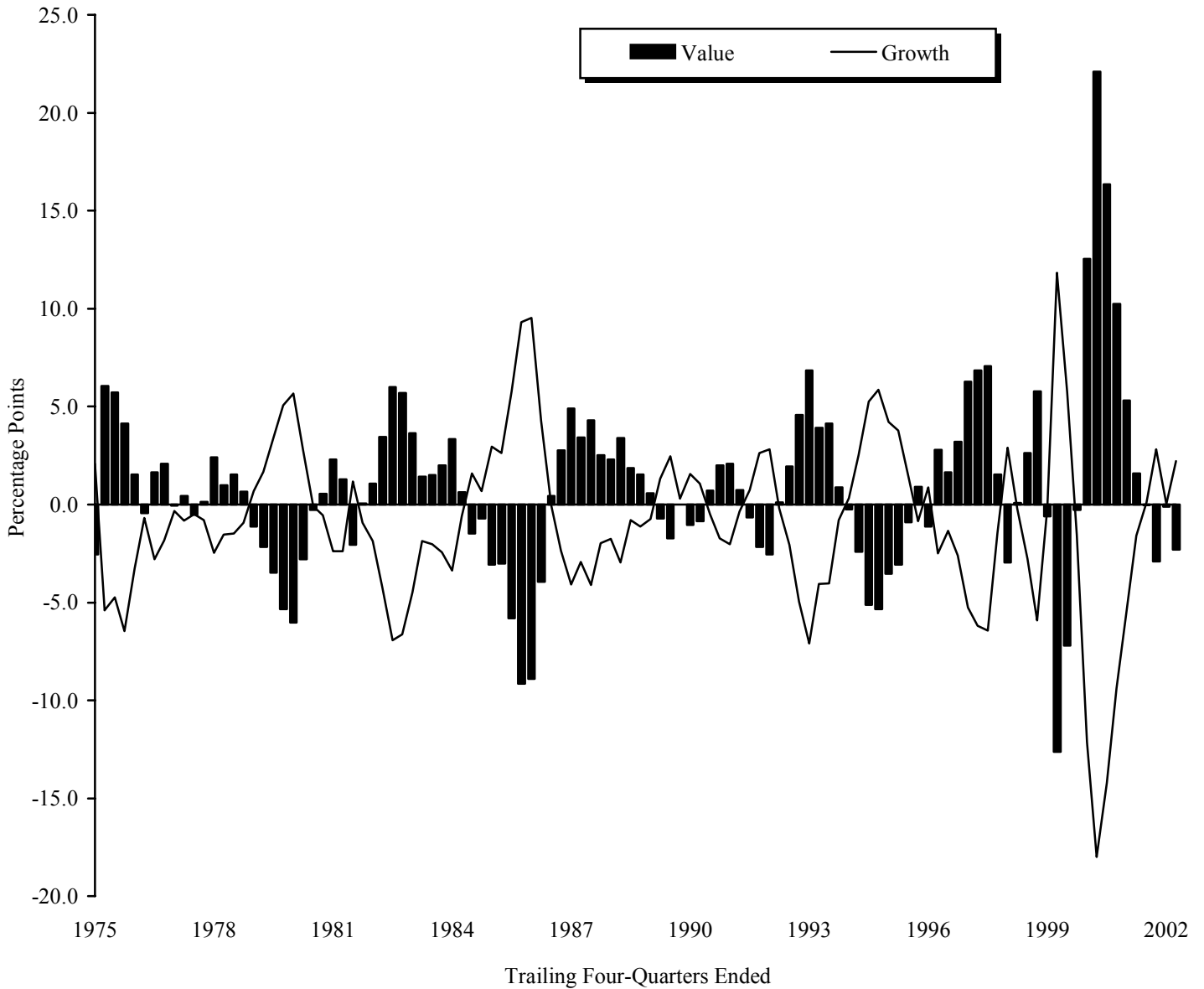
Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Table E

MSCI EUROPE EX U.K. GROWTH AND VALUE INDEX RETURNS RELATIVE TO MSCI EUROPE EX U.K.

1 January 1975 - 31 March 2003

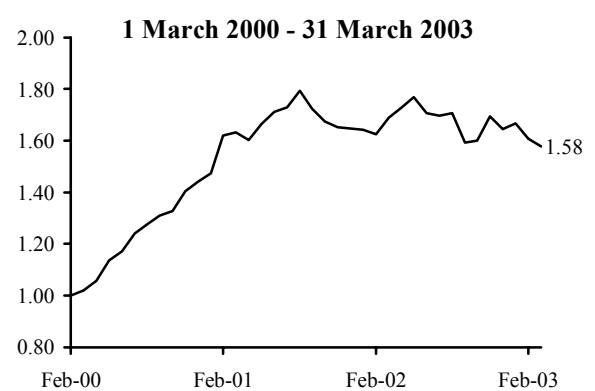
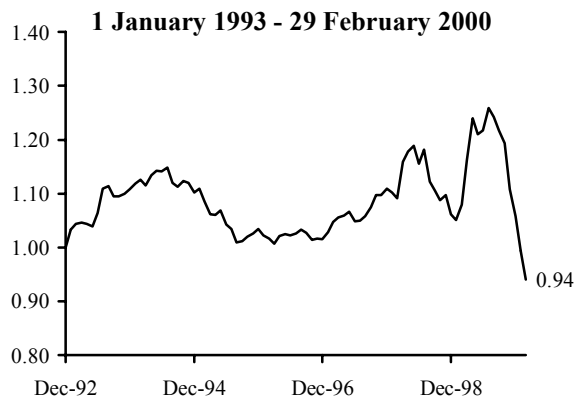
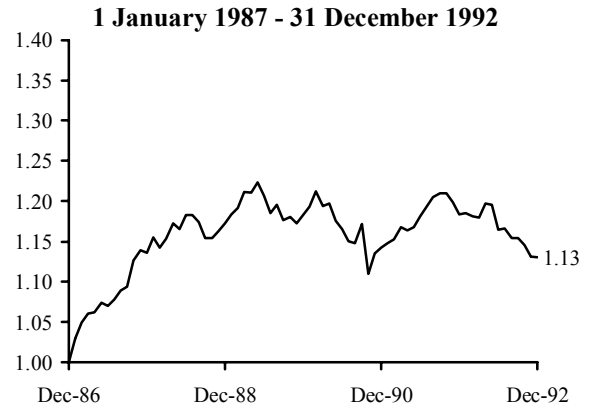
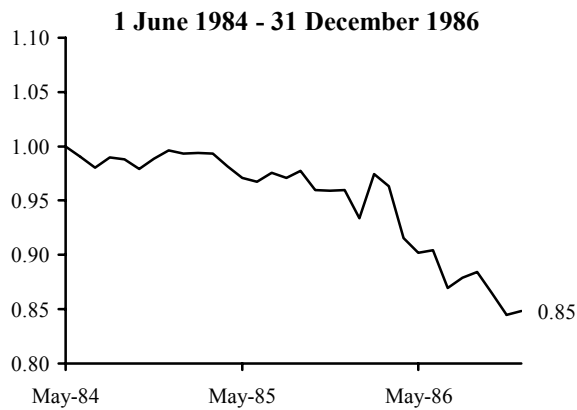
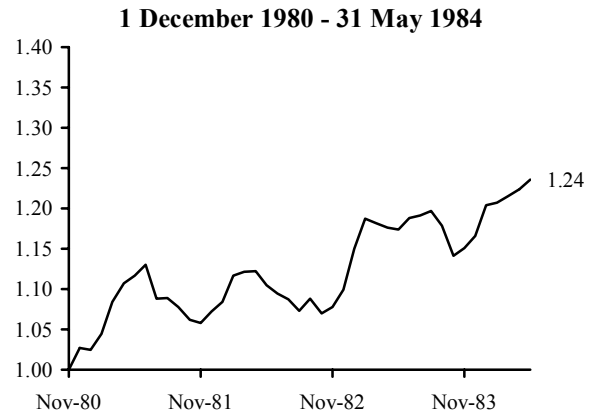
Differential
Above/Below MSCI
Europe ex U.K. Index



Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Table F

MSCI EUROPE EX U.K. VALUE RELATIVE TO MSCI EUROPE EX U.K. GROWTH OVER DIFFERENT PERIODS



Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.