Overweight Developed Markets Value Equities vs Developed Markets Equities

Recommended Since June 30, 2020

INVESTMENT THESIS: We expect value equities to outperform broad equites in developed markets, given the style's attractive valuation multiples, our expectation that it will outperform when economic activity improves, and that a secular shift to more normalized interest rate policy could be more supportive to value equities than the broad index.

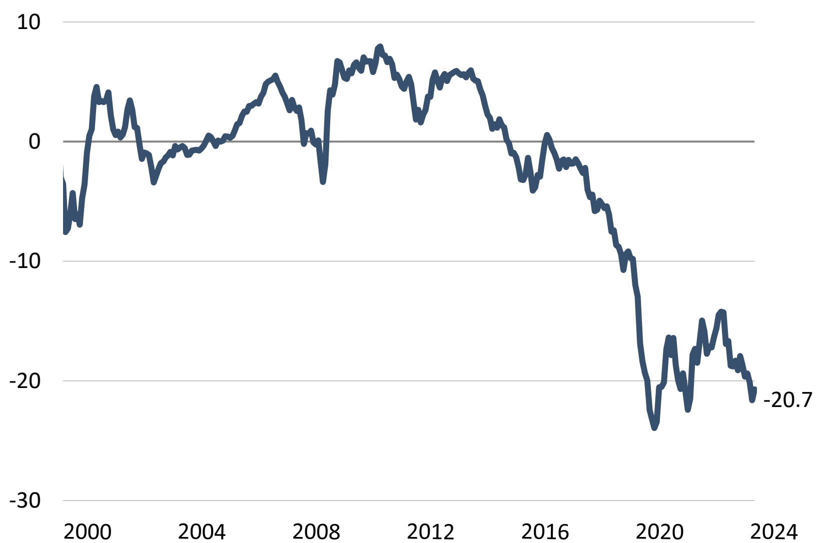
- **KEY SUPPORT #1:** Value equities trade at a discount relative to broad equities. Using the MSCI World Value Weighted Index and the MSCI World Index as our proxies, value equities trade at 9.3 times trailing five-year cyclically adjusted earnings, while broad equities trade at 15.5 times. That gap is wider than the typical valuation gap between these two blocs and has widened after the recent surge in AI-related tech stocks pushed growth valuations higher. The relative valuation is now 21% below the long-term median discount, after bottoming at 24% in late 2020. A further closing of that valuation discount would support value equity performance.

- **KEY SUPPORT #2:** Value equities have often held up better than broader equities in higher rate environments. While we expect that most central banks will cut rates modestly in 2024, costs of capital will remain higher than in the past decade. This should support value, particularly relative to growth stocks that could see headwinds from higher-for-longer rates.

- **KEY RISKS:** Value tends to underperform in recessions, given its larger exposure to cyclical sectors. Downturns are also associated with reductions in costs of capital, which tend to be beneficial to sectors that value indexes often underweight, such as information technology. Moreover, the recent boom in artificial intelligence stocks could persist, which could keep growth stock valuations elevated.

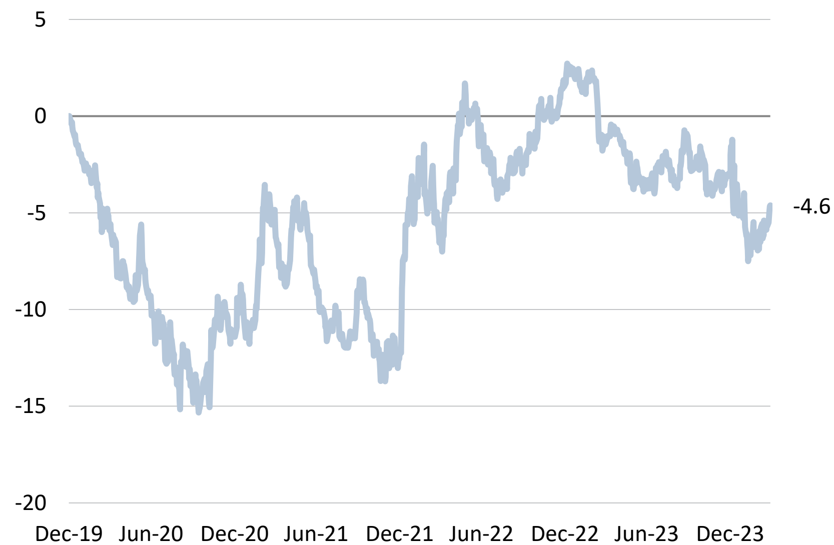
RELATIVE NORMALIZED P/E RATIO: PERCENT (%) FROM MEDIAN

January 31, 2000 – March 31, 2024



CUMULATIVE RELATIVE RETURN SINCE PRE-PANDEMIC LEVEL

December 31, 2019 – March 31, 2024 • Percent (%)



Sources: MSCI Inc. and Thomson Reuters Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Relative normalized P/E ratio and relative returns are both based on the MSCI World Value Weighted Index versus the MSCI World Index. All data are in US Dollar terms. Relative normalized P/E data are monthly and are based on an adjusted price-to-cash earnings ratio. The cyclically adjusted price-to–cash earnings (CAPCE) ratio is calculated by dividing the inflation-adjusted index price by trailing five-year average inflation–adjusted cash earnings. Cash earnings are defined as net income from continuing operations plus depreciation and amortization expense. MSCI does not publish cash earnings for banks and insurance companies and therefore excludes these two industry groups from index-level cash earnings. Performance data are daily and are based on total returns net of dividend withholding taxes.