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 and our expectation that AI enthusiasm is largely priced into growth stocks at this point, which could open the door for value outperformance on a relative basis.

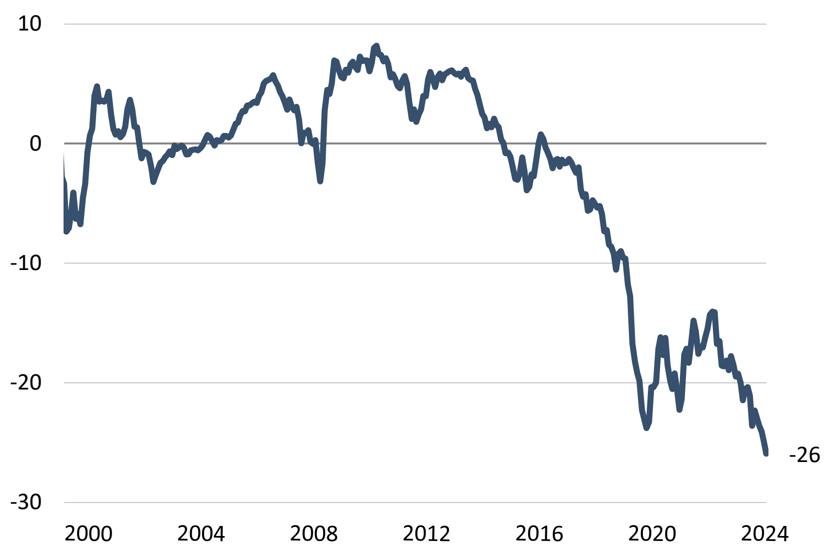
- **KEY SUPPORT #1:** Value equities trade at a discount relative to broad equities. Using the MSCI World Value Weighted Index and the MSCI World Index as our proxies, value equities trade at 9.2 times trailing five-year cyclically adjusted earnings, while broad equities trade at 16.4 times. That gap is much wider than the typical valuation gap between these two indexes. In fact, the relative valuation is now 26% below the long-term median discount, the widest discount on record. A closing of that valuation discount would support value equity outperformance.

- **KEY SUPPORT #2:** Large-cap growth stocks, driven by AI enthusiasm, have surged in recent years, with the "Magnificent 7" making up more than 40% of the MSCI World Growth Index. Throughout 2025, investors may adjust expectations due to sustainability concerns and uncertain AI-return timelines. This recalibration could benefit value stocks, as investors seek more undervalued opportunities relative to the broader index.

- **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.

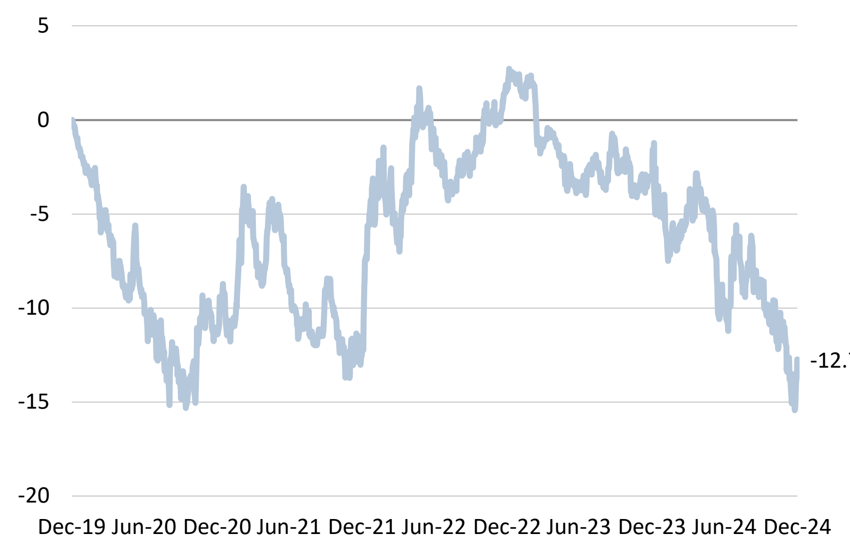
RELATIVE NORMALIZED P/E RATIO: PERCENT (%) FROM MEDIAN

January 31, 2000 – December 31, 2024



CUMULATIVE RELATIVE RETURN SINCE PRE-PANDEMIC LEVEL

December 31, 2019 – December 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.