

Value Investing and Skiing May be The Key to Living Longer

By Steven Smith / September 20, 2019

A recent column entitled, [Survivor Bias: Why Successful Value Investors Live Longer](#), mused on the apparent longevity of legendary value investors Charlie Munger and Warren Buffett. Today's long suffering value investors, looking for a silver lining in the decade plus underperformance of value stocks, may find one in Munger's quip that "professors, judges and value investors live longer." Munger (95) has been Buffett's (88) right-hand man at Berkshire Hathaway since 1978.

What might be responsible for this gerontological outperformance? Is it the zen of patient investing? Or maybe just from drinking so much Coke. (Berkshire is Coca Cola's largest shareholder.) We may never know the answer to that question. But it's well worth exploring the longevity of the so-called value premium.

The Ghost of Benjamin Graham

Value investing has its roots in the work and the teachings of Warren Buffet's mentor, Benjamin Graham. As propounded in Graham's classic treatises, *Security Analysis* (1934) and *The Intelligent Investor* (1949), value investing involves buying an investment at a market price below what you believe it is worth today; and then patiently waiting for the market to recognize its value so you can sell at a profit.

On a company-by-company basis, that may have been easier to do a generation ago when information about companies was more opaque, competition among investors was less formidable and the market far

less efficient. Today, value investing is more systematic; assembling portfolios of companies that are “cheaper” than average based on ratios like price/book (P/B) or price/earnings (P/E). As opposed to owning “growth” stocks, whose multiples are higher than average, with investors believing just the opposite: that the fundamentals will eventually catch up to the higher prices.

Value Premium – The Evidence

Multifactor World blogger Jared Kizer [assembles the evidence](#), showing that over the 90-year period from 1927 – 2017, value has outperformed growth by 4.8% per year. In an informative essay entitled, [Where’s the Value?](#) our friends at Dimensional Funds Advisors pegs the value premium a bit lower, at 3.5% annually.

But in any event premiums have to be earned; principally by enduring – sometimes long – periods in which they are AWOL. And owning unloved, relatively lower priced stocks – hasn’t been much fun over the last decade. Similar to the “[lost decade](#)” from January 2000 through December 2009, when the S&P 500 Index, which historically had produced a 10% annualized return, lost 0.95% per year. Clearly it would have been a mistake to abandon US stocks after that dismal performance as they have tripled in value in the decade since.

Despite the considerable long-term premium earned by value stocks, growth stocks have outperformed value stocks by a cumulative 32.2% from January 2007 – September 2018. And there have been five periods of even worse underperformance for value, but usually over a shorter period.

The research team at Dimensional calculates that in 84% of the overlapping ten-year periods between 1926 and 2017 Value

outperformed Growth. Meaning we have been in one of the 16% “other periods” for the last decade.

There are various theories around the cyclicity of growth and value. A prominent fundamental explanation being the emergence of new technologies (fueling a growth regime) followed by the deployment of those technologies by more traditional industries (favoring value stocks.) And then there are behavioral explanations, like the herd mentality of exuberant investors charging into so-called glamour stocks, regardless of price.

Measuring Value

Some have speculated that the value premium is gone forever. Others believe it may well reappear but be weaker in the future. Still others suggest we may need better instruments to measure it; pointing out that high technology companies have little in the way of book value (a traditional denominator) and rely more on brain power, computing power and intellectual property which, unlike land, factories and warehouses, may not show up on the balance sheet.

And value is just one of the “factors” which can be employed to enhance portfolio returns. Factors are identifiable characteristics within a group of securities that tend to explain performance. For a comprehensive look at factor-based investing, I highly recommend [*Your Complete Guide to Factor-Based Investing*](#), Andrew L. Berkin and Larry E. Swedroe (BAM Alliance Press 2016). The book identifies a half dozen or so factors out of the “factor zoo” that are worth studying and potentially implementing in a portfolio.

Don't Put All Your Factor Eggs in One Factor Basket

So it may help to add some of the more recent innovations in factor investing, such as having a “quality” or “profitability” overlay – which may eliminate or at least diminish the possibility of being caught in a “value trap” where it looks like value but is just a company on its way to bankruptcy.

And it makes good sense to diversify among several of the additional factors; including the size factor (small-cap stocks tend to outperform large-cap stocks) and the momentum factor. Try to count on a little bit of performance juice from each of them. And even though they tend to add value at different times; don’t try to time them. Just like “timing the market” – it’s impossible.

A Quickening?

Yes, it’s absurd to consider whether a two week change in a long-term pattern might be just a head fake or actually represent a secular shift. But it must be reported.

To begin with, after more than a decade of underperformance, the valuation gap between value stocks and growth stocks is bigger than it has ever been. The P/E ratio of growth stocks currently stands at 32 – vs. a historical median of 20. While the current P/E ratio of value stocks stands at 10 – vs. a historical median of 11.

With that background, during the first two weeks of September, the Russell 1000 Value Index gained 1.6%, while the Russell 1000 Growth Index decline 1.4%. And the MSCI USA Momentum Index (which is dominated by growth stocks) dropped 3.1%.

Is this the beginning of a trend? Nobody knows. Cheap stocks can get even cheaper. And it never makes sense to change strategy based on short-term market movements. Of course, it would be folly to *only*

invest in value stocks. But if you already have a solid investment foundation by incorporating a tilt (overweight) to value stocks in your portfolio or are otherwise assessing your long-term asset allocation strategy, it may be a sign of things to come.

Live Long and Prosper – And Go Skiing

There may not be any evidence, beyond anecdotal, that successful value investors live longer. And it may just be tautological: We have to live longer to endure these decade or longer droughts. But if value investing isn't the key to living longer, then surely, hopefully...it must be skiing.

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