

“Value” vs. “Growth”

Considerations When Defining and Capturing Value

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Value & Growth

Historical Performance

Historical Performance of Value and Growth

While large “growth” has fared well over the last 10 years, over the long-term, small “value” has delivered a premium over the market and other size and style segments.

- Small “growth” has lagged other segments since inception of the Russell indices

Annualized Returns for US Indices (%)

	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception
Russell 3000 Index	-5.88	18.80	19.93	16.11	9.72	12.24
Russell 1000 Growth Index	-8.58	17.52	26.44	22.28	10.86	12.26
Russell 1000 Value Index	-2.33	23.37	13.84	10.48	8.34	11.98
Russell 2000 Growth Index	-13.40	-15.04	11.36	10.93	9.20	9.81
Russell 2000 Value Index	-5.83	14.75	11.72	7.92	9.18	12.61

Source: Avantis Investors, data from Morningstar and Russell as of January 31, 2022. Inception date is 1/1/1979 for all indices.

Historical Performance of Value and Growth

Can you identify any discernible pattern in the table below?

Calendar Year Returns for US Indices (%)

1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	
50.84	52.26	14.85	28.52	38.64	10.10	32.85	19.98	5.31	29.47	35.92	-0.26	51.19	29.14	
35.38	39.57	1.26	20.98	28.29	3.39	32.15	16.72	1.92	23.16	29.31	-5.11	41.70	13.58	
24.12	32.50	-4.42	20.74	22.74	2.27	31.52	15.36	0.50	20.37	25.19	-8.08	41.27	9.59	
23.90	25.39	-9.24	20.46	20.13	-0.95	31.01	7.41	-7.11	17.83	20.17	-17.41	33.68	7.77	
20.55	24.41	-11.31	20.04	15.98	-15.83	30.97	3.58	-10.48	11.27	12.43	-21.77	24.55	4.99	
1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	
23.77	2.62	38.36	23.12	35.18	38.71	43.09	22.83	14.02	-11.43	48.54	22.25	7.05	23.48	
18.07	0.19	37.18	21.82	31.78	24.14	33.16	7.01	-5.59	-15.52	46.03	16.49	6.12	22.25	
13.37	-1.54	36.80	21.64	31.78	15.63	20.90	-7.46	-9.23	-21.54	31.06	14.31	5.26	15.72	
10.88	-1.98	31.04	21.37	30.49	1.23	7.35	-22.42	-11.46	-27.88	30.03	11.95	4.71	13.35	
2.87	-2.43	25.75	11.26	12.95	-6.45	-1.49	-22.43	-20.42	-30.26	29.75	6.30	4.15	9.07	
2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
11.81	-28.92	37.21	29.09	2.64	18.05	43.30	13.45	5.67	31.74	30.21	-1.51	36.39	38.49	28.27
7.05	-36.85	34.47	24.50	1.03	17.51	34.52	13.05	0.48	17.34	22.17	-5.24	31.02	34.63	27.60
5.14	-37.31	28.34	16.93	0.39	16.42	33.55	12.56	-1.38	12.74	21.13	-8.27	28.48	20.89	25.66
-0.17	-38.44	20.58	16.71	-2.91	15.26	33.48	5.60	-3.83	11.32	13.66	-9.31	26.54	4.63	25.16
-9.78	-38.54	19.69	15.51	-5.50	14.59	32.53	4.22	-7.47	7.08	7.84	-12.86	22.39	2.80	2.83

Russell 3000 Index
Russell 1000 Growth Index
Russell 1000 Value Index
Russell 2000 Growth Index
Russell 2000 Value Index

Source: Avantis Investors, data from Morningstar and Russell

Value & Growth

Traditional Definitions

Value & Growth – Traditional Definitions

How many companies that are in the Russell 1000 Value Index are also in the Russell 1000 Growth Index?

- a. 0
- b. 57
- c. 206
- d. 322

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

How many companies that are in the Russell 1000 Value Index are also in the Russell 1000 Growth Index?

- a. 0
- b. 57
- c. 206
- d. 322**

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

How many companies that are in the Russell 2000 Value Index are also in the Russell 2000 Growth Index?

- a. 0
- b. 432
- c. 648
- d. 941

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

How many companies that are in the Russell 2000 Value Index are also in the Russell 2000 Growth Index?

- a. 0
- b. 432
- c. 648**
- d. 941

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

What about other index families? How many companies that are in the S&P 600 Value Index are also in the S&P 600 Growth Index?

- a. 0
- b. 187
- c. 230
- d. 327

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

What about other index families? How many companies that are in the S&P 600 Value Index are also in the S&P 600 Growth Index?

- a. 0
- b. 187**
- c. 230
- d. 327

As of December 31, 2021. Source: Morningstar Direct

Value & Growth – Traditional Definitions

Some questions for us to consider...

Why are there so many companies that are included in both growth and value indices?

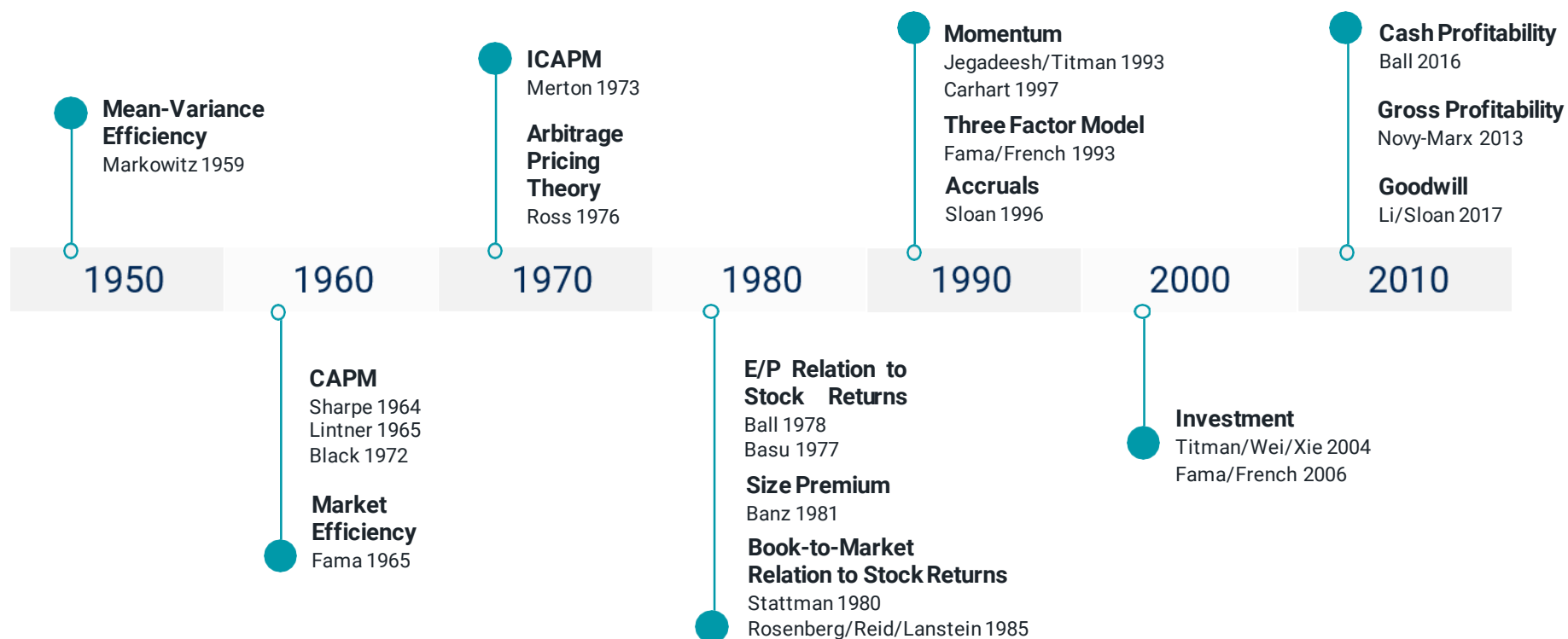
Are “growth” and “value” mutually exclusive?

What should I care about as an investor?

A More Modern Approach to Value Investing

The Evolution of Financial Science

There is a wealth of research that has uncovered insights as to what drives expected stock returns.



Which Company has Higher Expected Returns?

Consider an example with two companies, Company A and Company B



	Price/Share	Equity	Profits	Price/Share	Equity	Profits
Case 1	\$25	\$100m	\$10m	\$25	\$200m	\$10m

Which Company has Higher Expected Returns?

Consider an example with two companies, Company A and Company B



	Price/Share	Equity	Profits	Price/Share	Equity	Profits	Higher E(R)?
Case 1	\$25	\$100m	\$10m	\$25	\$200m	\$10m	B Inc

Paying less for the equity of companies increases expected returns

Which Company has Higher Expected Returns?

Consider an example with two companies, Company A and Company B



	Price/Share	Equity	Profits	Price/Share	Equity	Profits	Higher E(R)?
Case 1	\$25	\$100m	\$10m	\$25	\$200m	\$10m	B Inc
Case 2	\$25	\$100m	\$10m	\$25	\$100m	\$20m	

Which Company has Higher Expected Returns?

Consider an example with two companies, Company A and Company B



	Price/Share	Equity	Profits	Price/Share	Equity	Profits	Higher E(R)?
Case 1	\$25	\$100m	\$10m	\$25	\$200m	\$10m	B Inc
Case 2	\$25	\$100m	\$10m	\$25	\$100m	\$20m	B Inc

Getting higher equity value or more profits per dollar invested increases expected returns

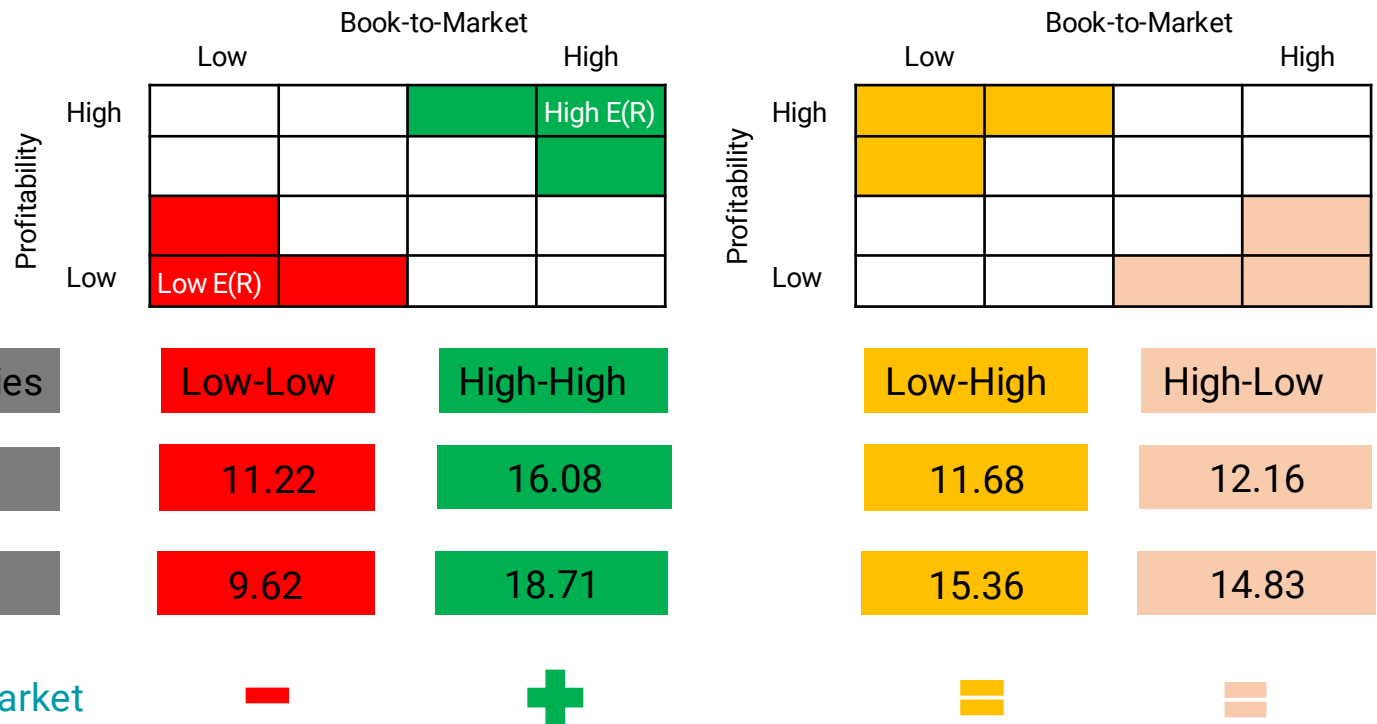
Valuation: A Powerful Framework

Value investing is often confused with buying companies at low prices, which is a misconception.

Price = Equity + $\frac{\text{Profits}}{\text{Discount Rate}}$	$\frac{\text{Equity}}{\text{Price}}$ AND $\frac{\text{Profits}}{\text{Equity}}$
Expected returns (discount rates) are a function of: Prices Current equity Expected profits	Differences in expected returns across securities are captured in valuation ratios Need to define Equity (modified B/M) Profits (cash-based operating profitability)

Value investing is about finding companies trading at a discount. The discount rate is our expected return.

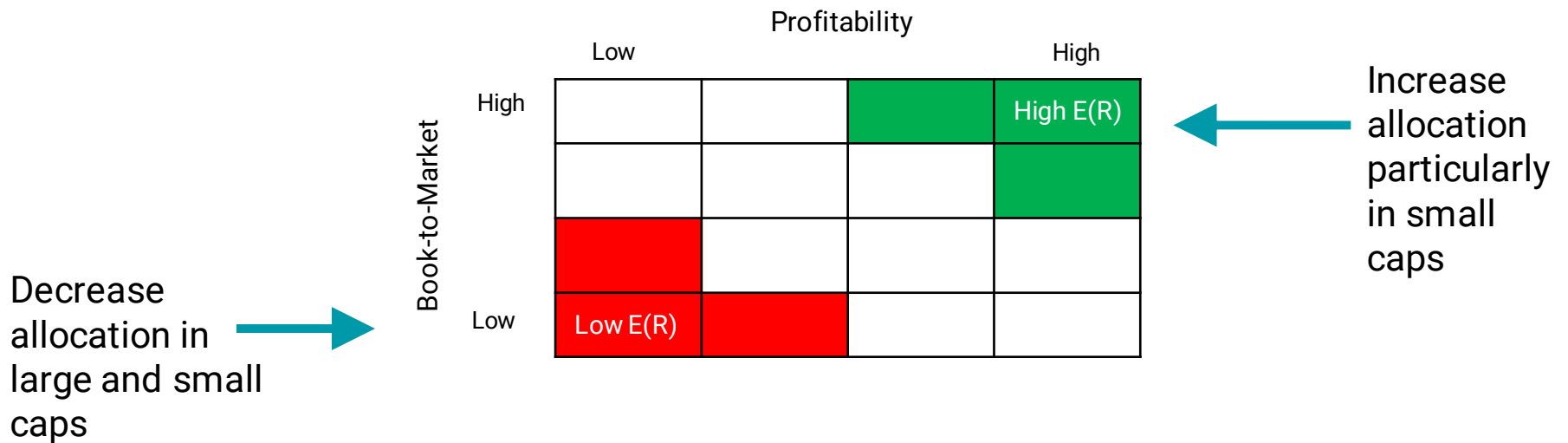
Implications for Expected Returns



Source: Avantis Investors and Sunil Wahal, CRSP/Compustat, US Securities, 1973-2020

Implementing Portfolios

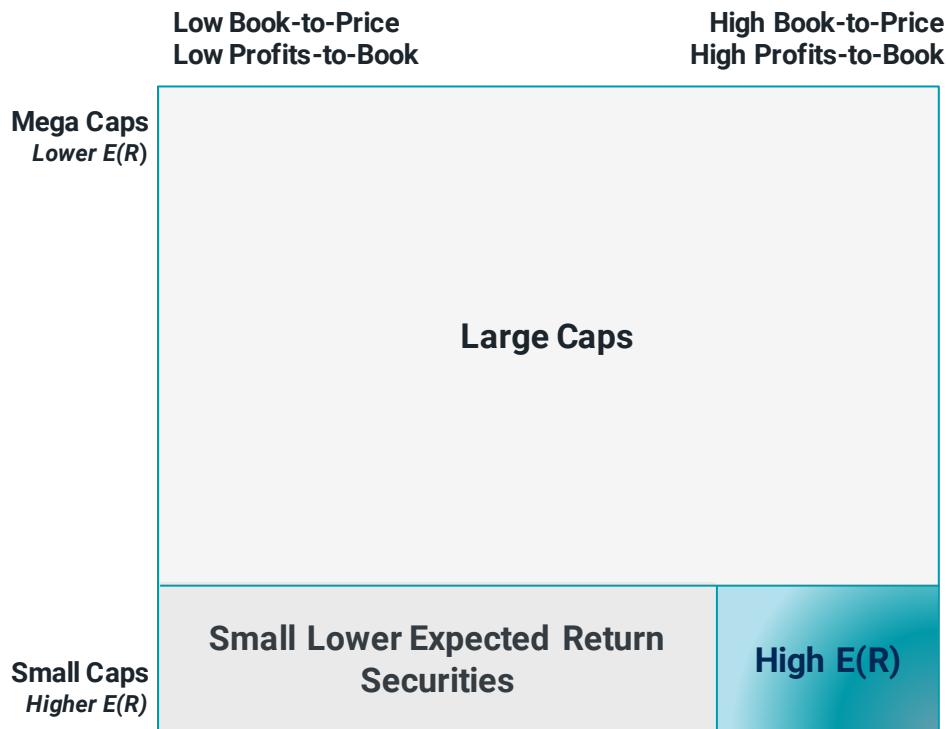
Goal: create an efficient portfolio with increased expected returns while minimizing deviations from the market and tracking error



Small Value Strategies

At-a-glance

Provides exposure to small cap companies, increasing expected returns over small cap benchmarks while providing broad diversification across companies and industries within the eligible universe.



Construction Details

Focused on small-cap value companies:

- Targets the highest expected returns securities that make up 25% of market capitalization within the small cap universe

Increase expected returns by:

- Continuous differentiation of securities when deciding under/over weights
- Focus on high expected return securities, high book-to-price/high profits-to-book and smaller companies
- Considering momentum, corporate activity and accrual effects on expected returns
- Avoid purchasing small companies with low profits-to-book and high levels of investment

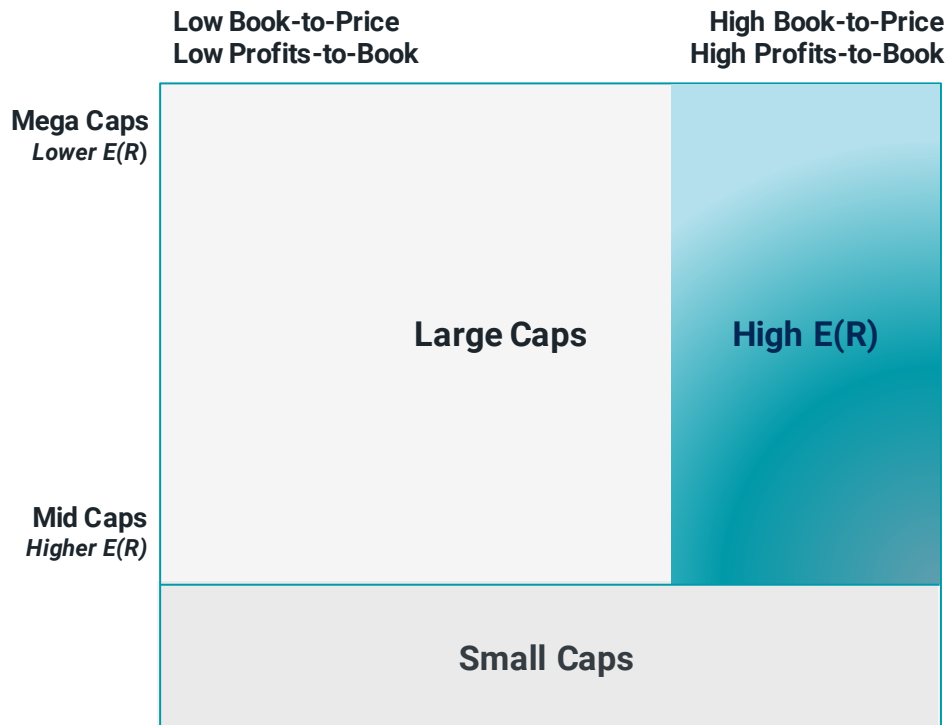
Risk Controls

- Broad diversification across sectors and industries
- Individual securities capped at 3%

U.S. Large Cap Value Equity

At-a-glance

Provides exposure to large cap companies in the eligible equity market, increasing expected returns over large cap benchmarks while providing broad diversification across companies and industries within the eligible universe.



Construction Details

Focused on large-cap value companies:

- Targets the highest expected returns securities within the large cap universe

Increase expected returns by:

- Continuous differentiation of securities when deciding under/over weights
- Focus on high expected return securities, high book-to-price/high profits-to-book and smaller companies
- Considering momentum, corporate activity and accrual effects on expected returns

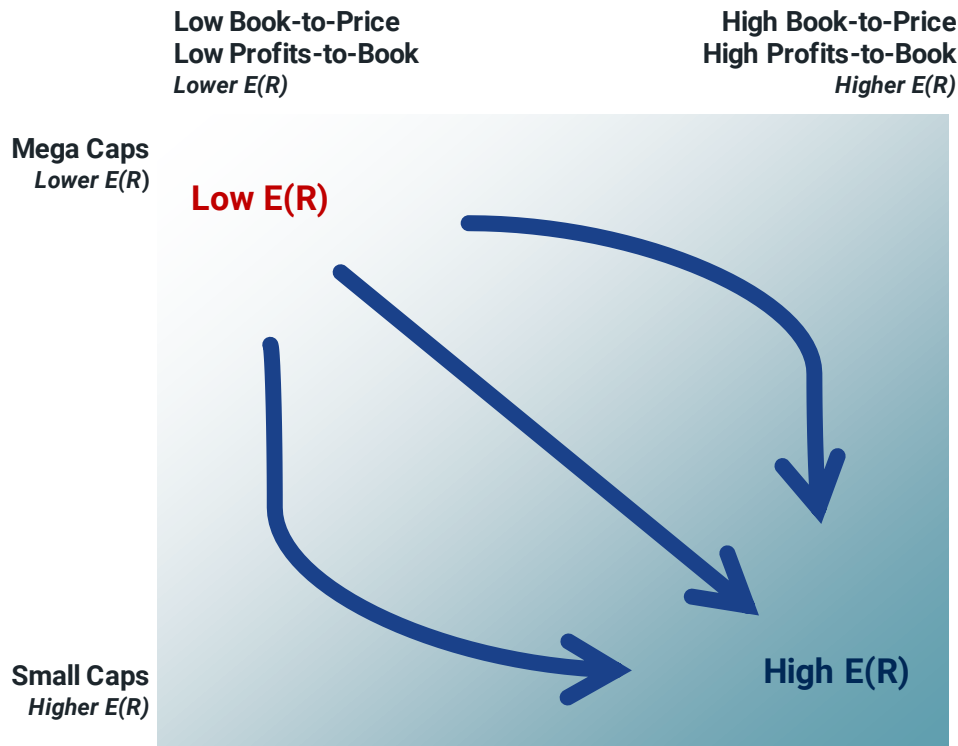
Risk Controls

- Broad diversification across sectors and industries
- Individual securities capped at 3% at purchase

All Cap Strategies

At-a-glance

Provides exposure to companies across capitalization ranges, designed to anchor an equity allocation while simultaneously increasing expected returns over broad market benchmarks.



Construction Details

Increase expected returns by:

- Continuous differentiation of securities when deciding under/over weights
- Underweighting mega cap companies with low profits-to-book and low book-to-price
- Overweighting smaller cap companies with high profits-to-book and high book-to-price
- Considering industry effects, e.g. utilities vs. non-utilities weighting scheme
- Considering momentum, corporate activity and accrual effects on expected returns
- Avoid purchasing small companies with low profits-to-book and high levels of investment

Risk Controls

- Broad diversification across sectors and industries
- Individual securities capped at 3%*

* Or up to a security's market capitalization weight in the market if greater than 3%

Summary & Questions

What Have We Learned?

Value and growth, while useful descriptors, are not mutually exclusive.

Certain stock characteristics are associated with premiums

A more modern approach to value considers both the balance sheet and the income statement in assessing companies

We can build portfolios that systematically target value to varying Degrees that are low-cost, broadly diversified and tax-efficient

**“Price is what you pay. Value is what you get.”
- Warren Buffett**

Disclosures

Expected Returns: Valuation theory shows that the expected return of a stock is a function of its current price, its book equity (assets minus liabilities) and expected future profits, and that the expected return of a bond is a function of its current yield and its expected capital appreciation (depreciation). We use information in current market prices and company financials to identify differences in expected returns among securities, seeking to overweight securities with higher expected returns based on this current market information. Actual returns may be different than expected returns, and there is no guarantee that the strategy will be successful.

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