TCW

INSIGHT

A New Era Dawning for Value

DIANE E. JAFFEE, CFA & CHRISTINE AN, CFP®, CIMA® | DECEMBER 2, 2019

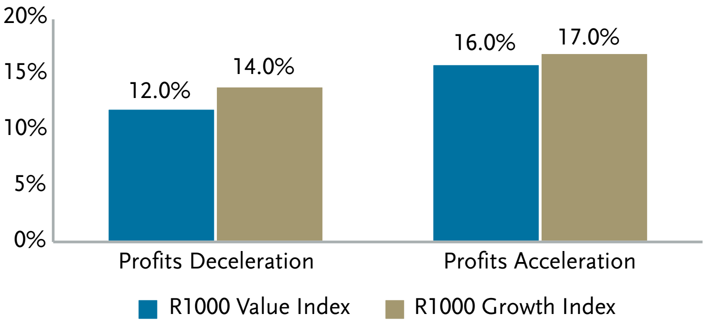
For the one year ending September 30, 2019, the Russell 1000 Value Index returned 4.0% outperforming the Russell 1000 Growth Index, which returned 3.7%. In the month of September alone, the pendulum significantly swung in favor of value stocks with the Value Index outperforming its Growth counterpart by 356 bps. We believe as a result of an increased interest in value stocks and improved investment sentiment, the S&P 500 Value Index is up 2.83% over the three months ending September 30, nearly four times the increase of its growth counterpart.

Since the Great Financial Crisis, investors have been fearful and nervous grappling with an uncertain and anemic economic growth environment. The past five years have been conducive to the outperformance of growth strategies and therefore has overwhelmed the 10-year returns. Growth stocks, which typically have earnings independent from the overall economy, were most favored as investors were willing to pay up for companies that displayed current high earnings growth. As investors tend to travel in herds, growth styles have become over crowded gaining positive momentum while the neglected value style lagged. During this growth environment, TCW Relative Value Large Cap strategy has outperformed the Russell 1000 Value Index on a net basis, 6 of the last 10 calendar years, and 2 of the last 3 years ending 2018 with zero style drift. TCW Relative Value Large Cap is attractive in a rising market, as historically, the strategy has displayed more upside return.

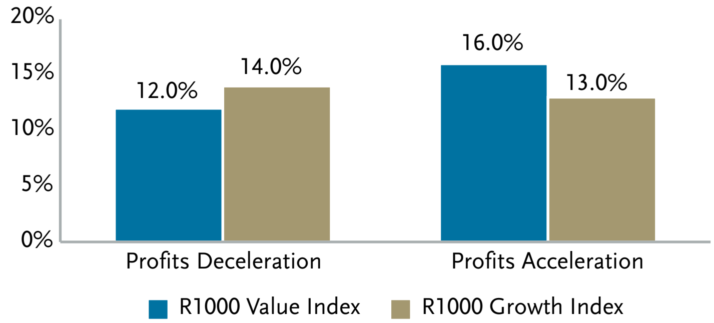
What portends the turning of the tide from Growth to Value?

As all things, Growth and Value are usually cyclical. Value tends to do better when the economy troughs at the end of a business cycle and when investors believe the environment is starting to look better. At this stage, investors have the ability to look forward 1 to 2 years for earnings growth. As the first chart on the following page illustrates, historically, as profits accelerated from 1982 through September 30, 2019, the Russell 1000 Value Index grew 16% per year, capturing 94% of the Russell 1000 Growth Index gains, even when including the tech bubble years (1998-2000) when Growth overall performed well. Excluding the tech bubble, the second chart shows Value outperformed when profits accelerated.

Including the Russell 1000 Growth Index gains of 48% annualized returns during the Tech Bubble, 1998-2000, the Russell 1000 Value captured 94% of the Growth returns when profits accelerate.



If we exclude the Tech bubble, Value wins when profits accelerate



Source: S&P, Russell, BofA Merrill Lynch US Equity & US Quant Strategy
As of September 30, 2019. Style Index performance during periods of decelerating and accelerating S&P 500 Index earnings growth (1982-present)

Profit cycles matter more than interest rates for Value to outperform Growth. Since 1926, accelerating profits constitute 92% of the return during rising rate environments and 88% of the returns during falling rate environments.

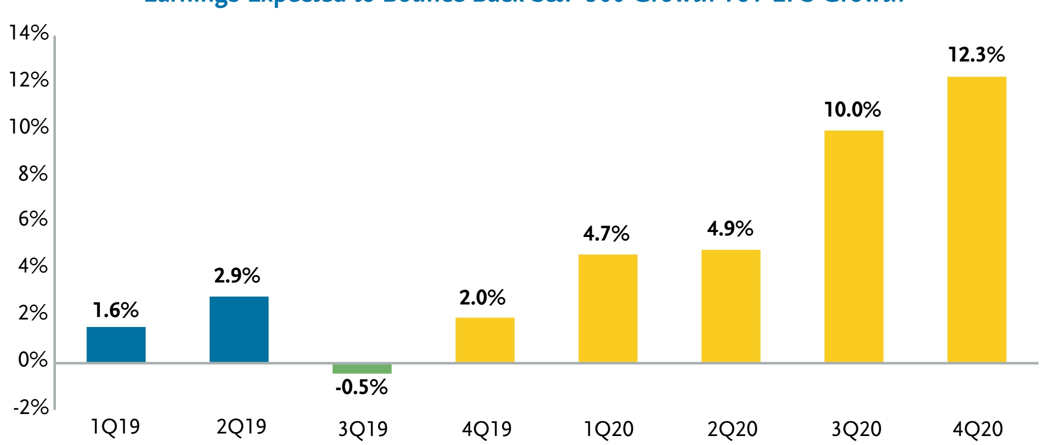
Value vs. Growth spread annualized average quarterly performance during profit and rates cycles since 1926

	Rising Rates	Falling Rates
Accelerating Profits	7.8%	7.9%
Decelerating Profits	0.7%	1.1%

Note: Growth and Value Indices based on Farma-French measure of Growth and Value
Source: BofA Merrill Lynch US Equity and US Quant Strategy, Fama-French Benchmark Portfolios historical returns, Federal Reserve Board

S&P 500 earnings are expected to trough in Q3:19* and accelerate to double digits by 2H:20. Massive global easing should aid in the acceleration with the U.S., Chinese, European, New Zealand, Thailand, Indian, and Australian central banks each in stimulus mode for the last six months. In our view, positive effects from synchronized global easing should be felt by year end and into the first half of 2020.

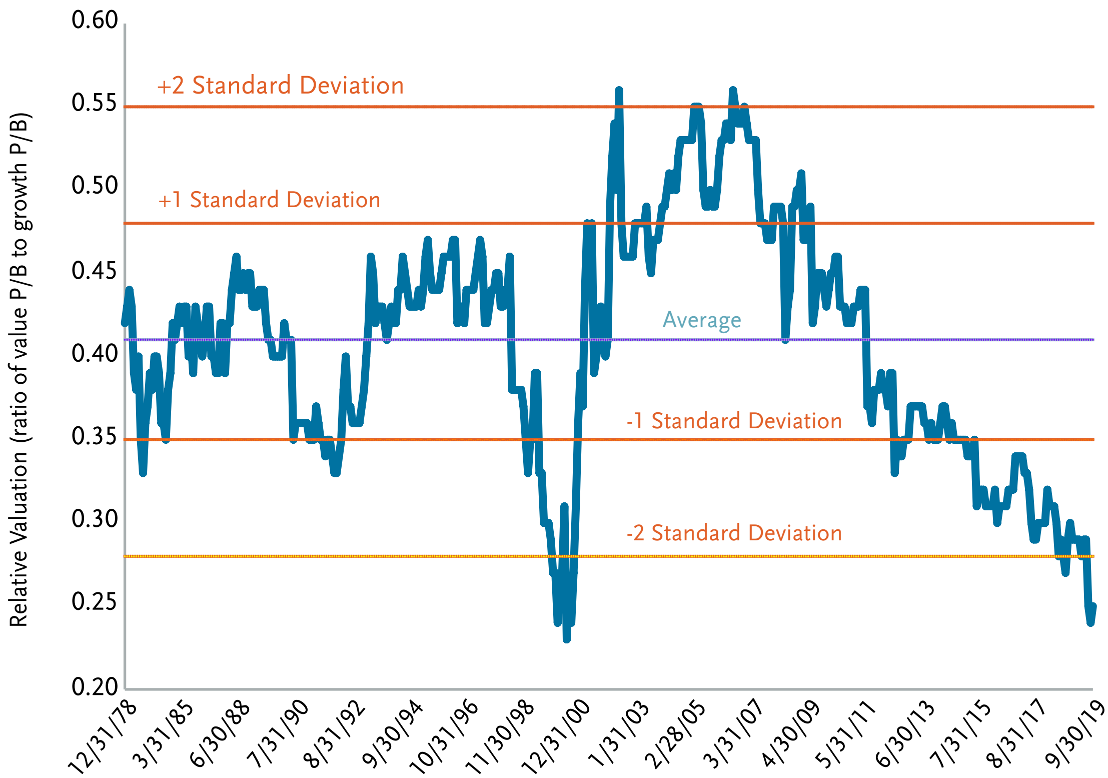
Earnings Expected to Bounce Back S&P 500 Growth YoY EPS Growth



Source: TCW, Bloomberg, Strategas, Bank of America, and Factset
Q3:19: With only 90% of companies reporting.

Growth looks expensive on multiple valuations such as book value, trailing/forward earnings, and sales. For example, the chart below illustrates that Value versus Growth is priced at over two standard deviations below the mean on a price-to-book basis as measured by the Russell 1000 Value and Growth Indices. Historically, a gap this extreme has led to significant value outperformance over multiple years. We believe investors should be aware of stylistic imbalances in their portfolios and stop thinking of value as “an insurance policy” and consider using Value as an offensive play to prepare for a regime change in the growth-versus-value cyclical performance trend. We always advocate for diversification, especially at times when valuations are stretched, and history creates a compelling case for an imminent change in market leadership. The economic cycle, profit cycle, global easing, and valuations all create a favorable backdrop to support the nascent trend we have been seeing for value to take the performance “baton”.

Relative Price-to-Book – Value vs. Growth the Uptick for Value in 2018 has Room to Grow
AS OF SEPTEMBER 30, 2019



Source: TCW, Bloomberg, Strategas, Bank of America, and Factset
*Q3:19: With only 90% of companies reporting.

> *“With valuations in many stocks and value sectors close to historically low levels, it is not surprising companies flush with cash and availability to low interest rates have begun to step up strategic acquisitions. While investors appear to have neglected value stocks for the past several years, firms are recognizing value and purchasing attractive companies that have been successfully executing on internal self-help catalyst(s), which have led to greater cash flow, operating margins, and earnings. This is why value investing cannot die.”*
>
> - Diane Jaffee, Senior Portfolio Manager of the TCW Relative Value strategies

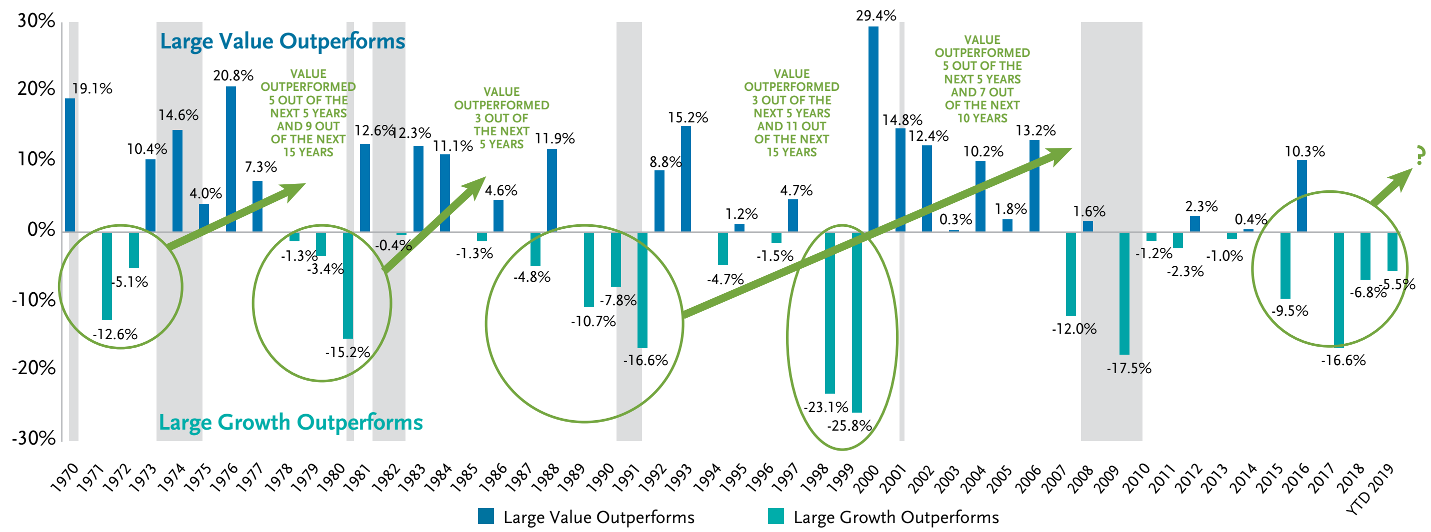
A look back at history

Since 1969, Value has outperformed on an annualized basis with less volatility as measured by standard deviation. There have been other periods where Growth dominated Value investing such as the five years ending 1991 when Value outperformed only one of the years. Post 1991, Value outperformed three of the next five years and 11 of the next 15 years. ■

Value vs. Growth: The Market Leadership Cycle

AS OF SEPTEMBER 30, 2019

Historically, Value Outperformed Since Inception and Conclusively Post Other Growth Phases Such as the One Ending 1991.



	Russell 1000® Index	Russell 1000® Value Index	Russell 1000® Growth Index
Annualized Since Inception (12/31/69-9/30/19	10.5%	11.1%	9.3%
Standard Deviation	17.0	15.6	19.9

Source: TCW, Bloomberg, Strategas, Bank of America, and Factset
*Q3:19: With only 90% of companies reporting.

Diane E. Jaffee, CFA | Group Managing Director | Relative Value Group

Ms. Jaffee is the Senior Portfolio Manager for the TCW Relative Value Large Cap, TCW Relative Value Dividend Appreciation, and TCW Relative Value Mid Cap strategies and funds. She joined TCW through the acquisition of SG Cowen Asset Management in 2001. She had been a Senior Portfolio Manager at Cowen Asset Management since 1995 and continues in that role at TCW. She has more than 30 years of investment experience. Before joining Cowen, she was Vice President and Portfolio Manager at Kidder, Peabody & Co from 1986 to 1995. Prior to that, she was Vice President at Lehman Management Company from 1985 to 1986 and an Equity Analyst with Prudential Insurance from 1982 to 1985. In 2007, Ms. Jaffee was named the Separately Managed Accounts Award winner in the Large Cap Equity category by Standard & Poor's and its award partners Prima Capital and Investment Advisor magazine. The TCW Relative Value Large Cap, Dividend Appreciation, and Mid Cap mutual funds have been each awarded Wall Street Journal's "Category Kings" in their respective categories, multiple times in 2012, and the TCW Dividend Appreciation Fund was ranked the #1, top performing fund among Lipper Equity Income Funds for 2012. In 2013, the TCW Relative Value Large Cap mutual fund was ranked #1 fund for the first quarter and the #6 fund for the one-year period ending March 31, 2013 among Large Cap Value peers, while the Dividend Appreciation Fund ranked #2 for the quarter and #3 for the one-year period ending March 31, 2013 among Equity Income peers. Ms. Jaffee holds a BA in Economics from Wellesley College (1982). She has completed post-graduate work in Finance and Accounting at Rutgers University Graduate School of Management and is a CFA charterholder. Ms. Jaffee is also a member of the New York Society of Security Analysts, the Economic Club of New York, and the CFA Society.

More recent ranking information is available, and that information may include different rankings for more recent periods

Christine An, CFP®, CIMA® | Vice President | Relative Value Group

Ms. An is a Product Specialist responsible for communicating investment strategies, performance and outlook to clients for the Relative Value Group. She joined TCW in 2014 as a member of the Wealth Advisor Group where she focused on sales and client services. Ms. An brings the firm nearly a decade of investment professional experience with previous roles at AssetMark and Fidelity Investments. During her tenure at AssetMark, she served as an Advisor Consultant for third party asset management programs catered to Registered Investment Advisors. Prior to that, Ms. An served as a member of the Private Client Group at Fidelity where she began her career in marketing and client services for high net worth clients. Ms. An earned a BA in Social Ecology from the University of California, Irvine and is an MBA candidate at Cornell University. She is registered with FINRA holding Series 6, 7, and 66 licenses. Additionally, she is a Certified Investment Management Analyst (CIMA) and Certified Financial Planner (CFP).

IMPORTANT PERFORMANCE DISCLOSURE

TCW Relative Value Large Cap Composite Performance
As of September 30, 2019

			Annualized						
	Q3 2019	YTD	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year	Since Inception 3/31/1995
TCW Relative Value Large Cap (Gross)	**-0.54%**	**18.93%**	**-1.68%**	**7.33%**	**6.25%**	**10.90%**	**7.60%**	**8.38%**	**11.22%**
TCW Relative Value Large Cap (Net)	**-0.71%**	**18.31%**	**-2.37%**	**6.58%**	**5.51%**	**10.12%**	**6.85%**	**7.59%**	**10.36%**
Russell 1000 Value Index	1.36%	17.81%	4.00%	9.43%	7.79%	11.46%	7.82%	6.93%	9.55%
Under/Outperformance (Gross)	*-190 bps*	*112 bps*	*-568 bps*	*-210 bps*	*-154 bps*	*-56 bps*	*-22 bps*	*145 bps*	*167 bps*

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