



INVESTMENT INSIGHTS BLUE PAPER | MARCH 2021

The unique time for US value: rotation
from growth plus innovation, quality
and ESG improvement

Confidence
must be earned

Amundi
ASSET MANAGEMENT

Executive summary



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The rotation towards value is a key theme of our 2021 investment outlook. As the US economy moves towards reopening and a return to normalcy, we expect an overly accommodative Federal Reserve (Fed) to let the economy 'run hot' in the near to medium term, meaning reflation and a steeper yield curve. With a 'V-shaped' recovery underway, such conditions -- combined with still excessive growth vs. value valuations -- we believe enable an optimal setup for US value to outperform beyond its initial move last September. Beyond that, US value offers a compelling opportunity to sustain medium- to long-term performance relative to both the US and global markets, as it provides a unique combination of structural growth, quality, ESG improvement, stability, defensiveness, and relative valuation support. Virtually all other segments of the market provide only one or two of these features, but US value has them all.



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Near-to-medium-term rationale for US value	Long-duration rationale of US value performance
<p>V-shaped recovery, liquidity and an accommodative Fed:</p> <ul style="list-style-type: none"> ■ The Fed has signalled its commitment to low rates for the foreseeable future and that it will let the economy 'run hot'. As a result, inflation expectations have surfaced for the first time in years, particularly when the Fed's new inflation regime is proactive in tolerating an overshoot beyond its stated 2% sustained inflation objective. ■ With a 'V-shaped' recovery well underway, we expect reflation and a steeper yield curve to result in optimal conditions for US value to outperform growth, especially when the valuations of growth stocks are at extreme levels relative to history. ■ One of the reasons for the growth outperformance of recent years has been the impact of declining interest rates on valuation multiple expansion. Equity valuations are equal to the discounted value of future profits. Long-duration, high-growth businesses benefit from a multiplier effect when rates decline. But as we expect to play out moving forward, the opposite is true as well. <p>Excessive valuation anomaly of US value relative to growth:</p> <ul style="list-style-type: none"> ■ Historically, value has outperformed growth, but this has not been the case since 2014, the longest stretch since the 1960s at least. Growth trades at the largest valuation premium to value since the 2000 tech bubble. The narrowness of the US market in the last couple of years suggests this anomaly is likely to end. ■ Since September 2020, the market has broadened and we have begun to see cracks in the dominance of growth vs. value. It is important to note that any recent performance of value vs. growth is only the tip of the iceberg; there is a long way to go before valuations get back into line with historical averages. 	<p>Structural growth:</p> <ul style="list-style-type: none"> ■ Nearly a quarter of the US value universe represents the next leg of innovation winners, as we expect the future incremental profit pools of the technological transformation of the economy (e.g., cloud infrastructure, automation, artificial intelligence, machine learning) to accrue to the firms with the size and scale to deploy new technology to transform their businesses. ■ The US is in the early stages of an investment cycle into economically viable renewables. Much of Europe has already converted, but the US could see 10 to 20 years of meaningful investment into profitable renewable projects. <p>Stability and defensiveness:</p> <ul style="list-style-type: none"> ■ There is a misperception that value must be deep value or distressed business models. However, we estimate that nearly half of the large-cap value index is comprised of companies with relatively stable and/or defensive characteristics that are also structural winners more often than not. We estimate that nearly half of US value represents stability and defensiveness. <p>Quality market with appealing valuation:</p> <ul style="list-style-type: none"> ■ The US market is at least as profitable, and in some cases more profitable, than the core markets of the rest of the world, as measured by return on invested capital. On valuations, when adjusted for profitability, US value measures up well with other regions and it is important not to conflate historically expensive US growth with the rest of the US market. US value could be an advantage for active portfolio management with a deep fundamental approach, combined with disciplined valuation, as the medium-term winners may not be obvious right away.

Near- to medium-term rationale for US value

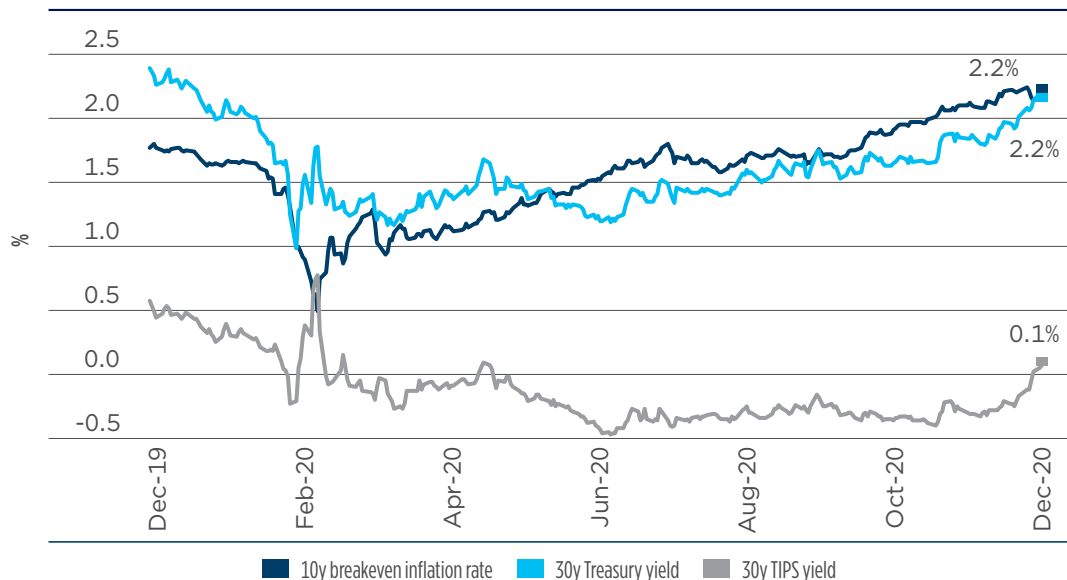
“We believe optimal conditions exist for US value to outperform US growth because of a combination of factors, including the likely normalisation of economic activity later in 2021, a continuation of unprecedented fiscal stimulus, and a very accommodative Fed. All-in, the stage is set for accelerating inflation for the first time in years, as well as higher bond yields.”

We believe optimal conditions exist for US value to outperform US growth because of a combination of factors, including the likely normalisation of economic activity later in 2021, a continuation of unprecedented fiscal stimulus, and a very accommodative Fed. All-in, the stage is set for accelerating inflation for the first time in years, as well as higher bond yields. The early stage of an economic recovery alone is typically sufficient for value to outperform. However, a historically excessive valuation gap between growth and value, along with reversal of the multiplier effect that low rates had on growth company valuation multiples, add more conviction to our view.

Macro set-up

The Fed has signalled that it is committed to low rates for the foreseeable future and will let the economy ‘run hot’. Specifically, the Fed wants to be sure that the US business cycle is closer to -- if not at -- its pre-Covid-19 trend growth path (meaning catch-up growth for both the real economy and inflation) before signaling an intent to slow nominal demand growth.

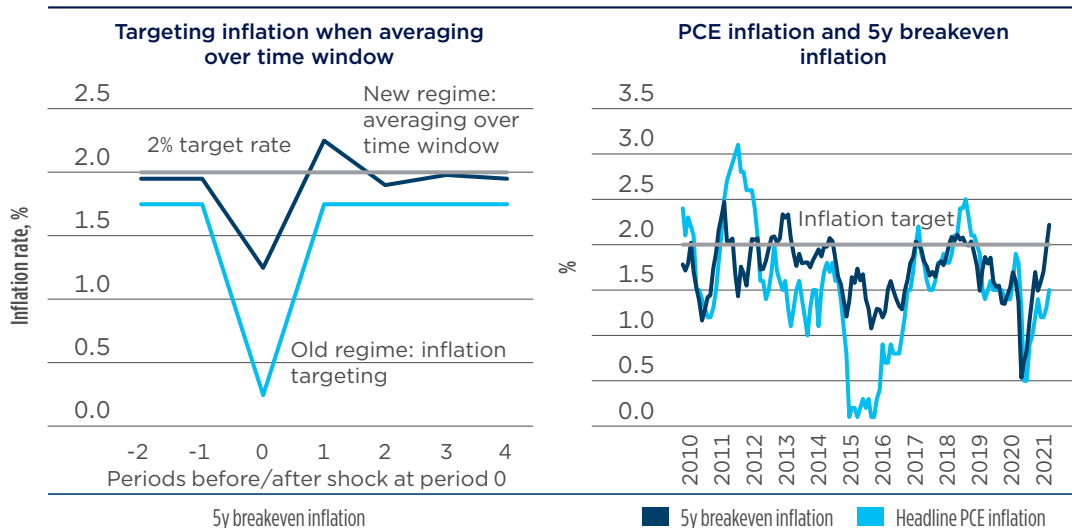
Figure 1. Yields and inflation expectations



Source: Amundi, Fred database. Data as of 24 February 2021. TIPS: Treasury inflation-protected securities.

As a result, inflation expectations have surfaced for the first time in years, particularly when the Fed's new inflation regime is proactive in tolerating an overshoot beyond its stated 2% sustained inflation objective.

Figure 2. New US inflation framework



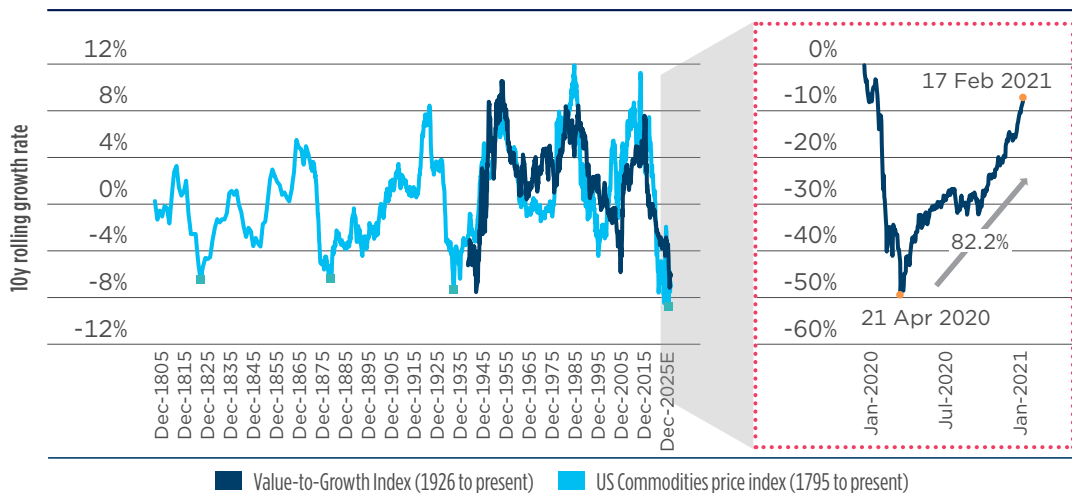
Source: Left chart: Federal Reserve of San Francisco as shown as of 10 August 2020. Right chart: Amundi, Bloomberg. Data as of 26 February 2021. PCE inflation: Personal Consumption Expenditures Price Index.

“With a ‘V-shaped’ recovery well underway and the anticipated normalisation in economic activity this year, there is real potential for overshooting given pent-up demand and continued fiscal support under the Biden administration.”

Unlike the post-global financial crisis (GFC) recovery, which took place over many years, the nominal economy (real GDP growth plus inflation) is expected to be back at its pre-Covid-19 trend by the end of 2021 or early 2022. Unlike the GFC, the Covid-19-induced recession was not the result of a bubble and there were no excesses for the economy to work through. It is estimated that the Covid-19 recession created only half as much structural US unemployment as the GFC, while the massive fiscal stimulus supported consumer spending and held inflation up in 2020.

With a ‘V-shaped’ recovery well underway and the anticipated normalisation in economic activity this year, there is real potential for overshooting given pent-up demand and continued fiscal support under the Biden administration. As such, we expect reflation and long-term bond yields to increase meaningfully, resulting in a steeper yield curve. This dynamic sets up optimal fundamental conditions for US value to outperform growth meaningfully, that should be aided by the excessive valuations of growth stocks relative to history.

Figure 3. Reflation may favour a rotation towards value. Historically, in the US, commodity prices and value stocks have shown strong correlations and require reflationary trends to rise



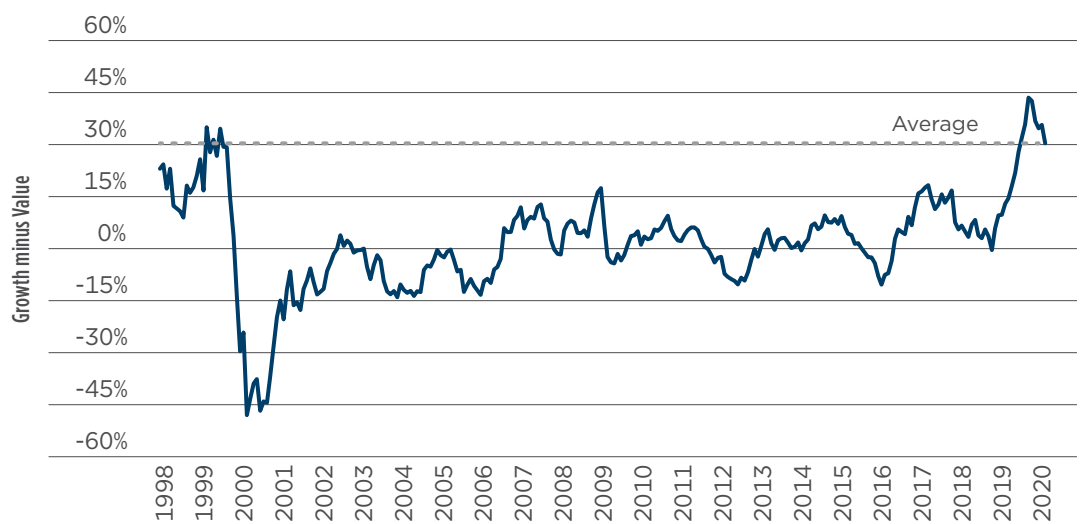
Source: Stifel Equity Research. Data as of 17 February 2021. Dark blue line represents US Commodity price index, a weighted average of selected commodity prices. Indices used in Stifel research: Warren & Pearson commodity index (1795-1912), WPI commodities (1913-25) and equal-weighted (one-third each). PPI energy, PPI farm products and PPI metals (ferrous and non-ferrous) ex-precious metals (1926-56), Refinitiv equal weight (CCI) index (1956-94) and Refinitiv core commodity CRB Index (1994-present). Light blue line represents the US Value vs. Growth index, which links the Fama/French (Dartmouth/Tuck web-hosted) series from 1926-77 and the Russell 1000 total return index, 1978-present. Right chart: Goldman Sachs commodities Index. Source: Bloomberg. Data are from 23 January 2020 to 17 February 2021 as shown.

“The post-GFC decline and sustained low level of interest rates and historically meager GDP growth over the past ten years has been a meaningful driver of the unprecedented outperformance of growth stocks.”

Valuation gap between US value and growth points to a resurgence of value performance

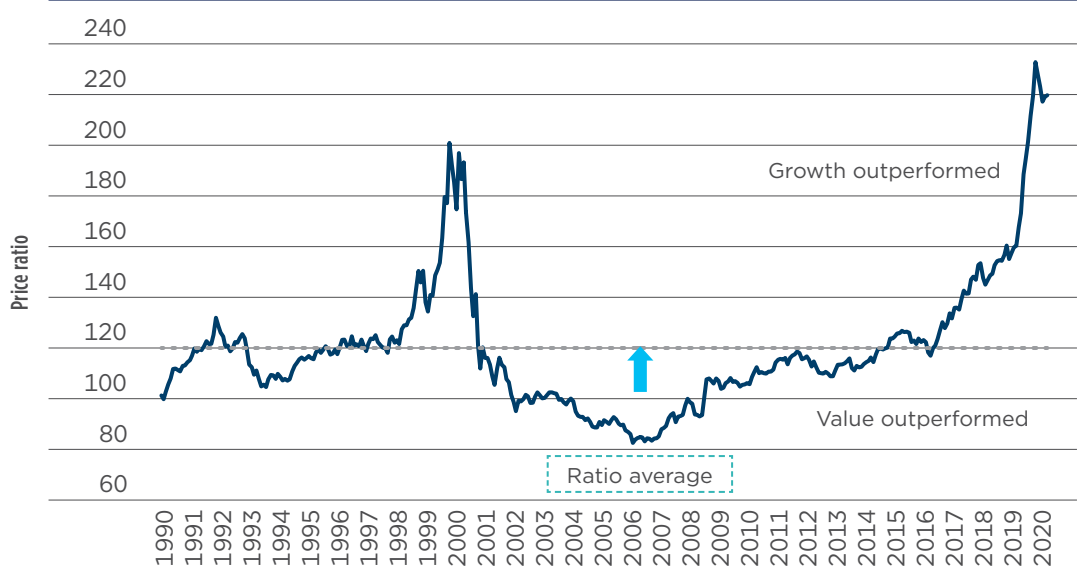
The post-GFC decline and sustained low level of interest rates and historically meager GDP growth over the past ten years has been a meaningful driver of the unprecedented outperformance of growth stocks. There are two components to this that get to a critical foundation of corporate finance in that equity valuations are equal to discounted future profits. When growth is scarce as it has been for the past ten years, investors will pay a premium for companies that can demonstrate growth as -- all else equal -- the more sustained growth, the higher future profits will be, and thus, the greater a stock is worth. Growth valuations have been amplified by the lower interest rates that are used to discount future profits. However, this is all about to change and growth is vulnerable while value is promising. The charts below demonstrate the growth-value disconnect.

Figure 4. Growth-value performance most disconnected since the tech bubble

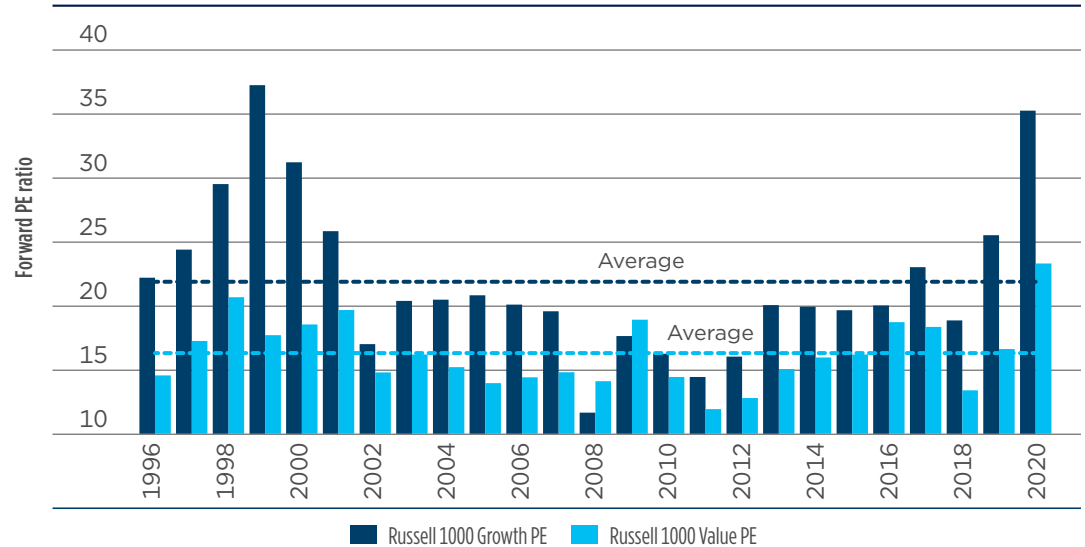


Source: Amundi, Bloomberg, as of 31 January 2021. **Past performance is no indication of future results.** Chart shows rolling 1y relative performance of the Russell 1000 Growth index compared to the Russell 1000 Value index in total return terms. The Russell 1000® Value index measures the performance of large cap US value stocks. The Russell 1000® Growth index measures the performance of large cap US growth stocks.

Figure 5. Growth outperformance dominance over value may have peaked



Source: Amundi on Bloomberg data as of 29 January 2021. **Past performance is no indication of future results.** The Russell 1000® Value index measures the performance of large-cap US value stocks. The Russell 1000® Growth index measures the performance of large-cap US growth stocks. Indices are unmanaged and their returns assume reinvestment of dividends and -- unlike mutual fund returns -- do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

Figure 6. Growth trades at the largest PE premium to value since 2000

Source: Amundi, Bloomberg. Data as of 31 December 2020. The Russell 1000® Value index measures the performance of large-cap US value stocks. The Russell 1000® Growth Index measures the performance of large cap US growth stocks. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index. Price-earnings ratio PE is the current price of a stock divided by the consensus analyst estimates of one-year projections of its earnings per share.

Nearly a quarter of value may represent next leg of innovation winners

“We expect the future incremental profit pools of the technological transformation of the economy to accrue to the firms with the size and scale to deploy the technology to transform their businesses.”

Until now, the primary beneficiaries of the increased technology spending on cloud infrastructure, subscription software-as-a-service, automation, artificial intelligence (AI), machine learning, and digitisation have been the suppliers of the technology. However, **we expect the future incremental profit pools of the technological transformation of the economy to accrue to the firms with the size and scale to deploy the technology to transform their businesses.** Combined with the valuation disparity with growth vs. value in which the excessive relative-growth valuations are these same firms, this is an interesting time for investors to evolve with them as valuations support it. Specifically, much of the innovation of industrial and financial cyclicals that have leading market positions and will exploit such technologies resides within value, less so in growth.

We believe this transformation is in the early stages of playing out. The companies deploying technologies such as cloud infrastructure, automation, and artificial intelligence have already spent vast amounts of capital, which is why the suppliers of the technologies have had massive growth in profits and market capitalisations. While the argument could be made that the value created from that investment has already shown up in higher market shares and greater efficiencies for the large industrials and financials, most of the value creation is yet to come for two primary reasons:

1. there will be significant capital investment; and
2. the return on that investment takes years to be realised.

For example, the market share growth of the big banks, while already increasing, will have years of acceleration as the technology investment is scaled. Similarly, factory automation is very early stage. **Thus, within value, we believe this dynamic is an advantage for active portfolio management with a deep fundamental approach, combined with disciplined valuation as the medium-to long-term winners may not be obvious right away.** By comparison, growth investing in some ways has become more straightforward because there is an immediate impact from technology spending

“The four biggest US banks collectively spend 1.5 times the more on technology per year than all the remaining US banks combined. This is reflected in their market share.”

on the revenue and profit growth of the technology suppliers. For example, the three dominant cloud services providers are well known and it is easy to follow their progress each quarter; the same can be said for software-as-a-service providers within each total addressable market. Investment performance becomes more of a valuation exercise, which still requires a thoughtful, fundamental view, but arguably is less complex and nuanced than assessing the winners of longer-term trends for the technology adopters such as structural improvements of efficiency ratios for banks, sustainably increased market shares, and less cyclical industrial operating margins. **Three groups that represent about 25% of the value index have transformational opportunities.**

1) Mega-cap banks

The four biggest US banks collectively spend 1.5 times the more on technology per year than all the remaining US banks combined. This is reflected in their market share. This tech spending is transforming the customer service experience, lowering costs, fraud prevention/cyber security, business-to-business payments flows, roboadvisors, etc.

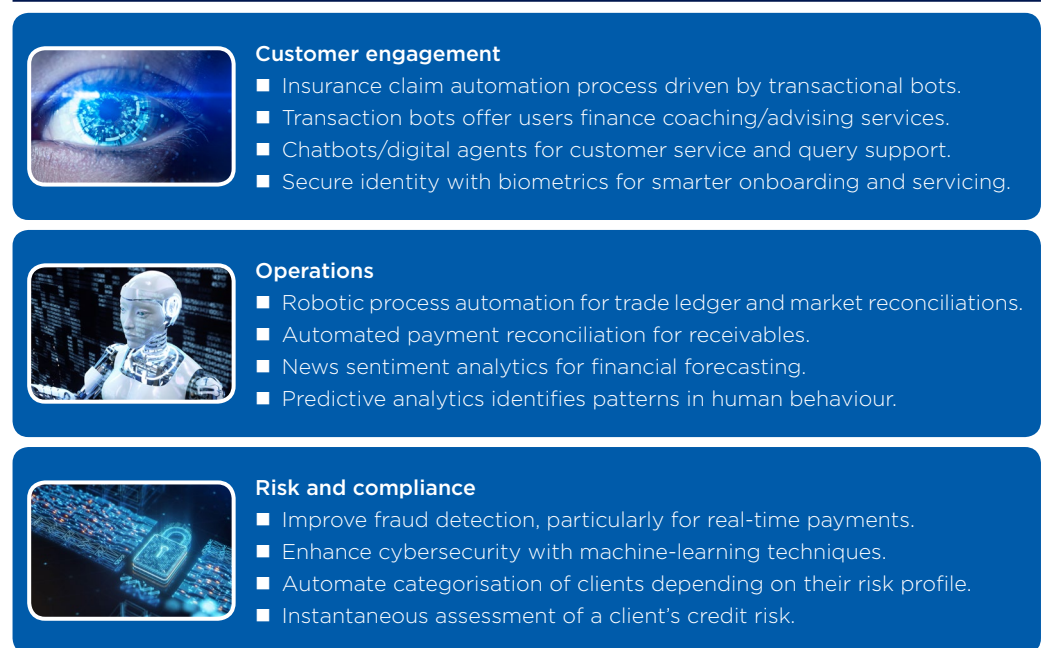
How the banks will transform

Technology is reshaping financial services dramatically with the best players evolving with consumer behaviours based on shifting demographics and rising customer expectations:

- **Gen-Z and millennials prefer digital banking** channels over branches, having used digital technology from a young age.
- **Trend towards mobile banking, mobile payments, mobile apps** -- anywhere, anytime, 24/7.
- **Cloud computing, artificial intelligence and blockchain enable digital revolution in financial services.**
- **Increased use of technology in financial services industry**, rise of internet and mobile applications for financial transactions.
- **Game changing technologies** like artificial intelligence, biometrics and blockchain will enhance customer experience and security.
- The biggest incumbents will leverage scale and trust to take advantage of their very high levels of tech spending to stay relevant, build market share and improve operating efficiency, all within the regulatory environment that governs the financial services industry.

Figure 7. AI is paradigm-shifting technology with many applications

“Technology is reshaping financial services dramatically with the best players evolving with consumer behaviours based on shifting demographics and rising customer expectations.”

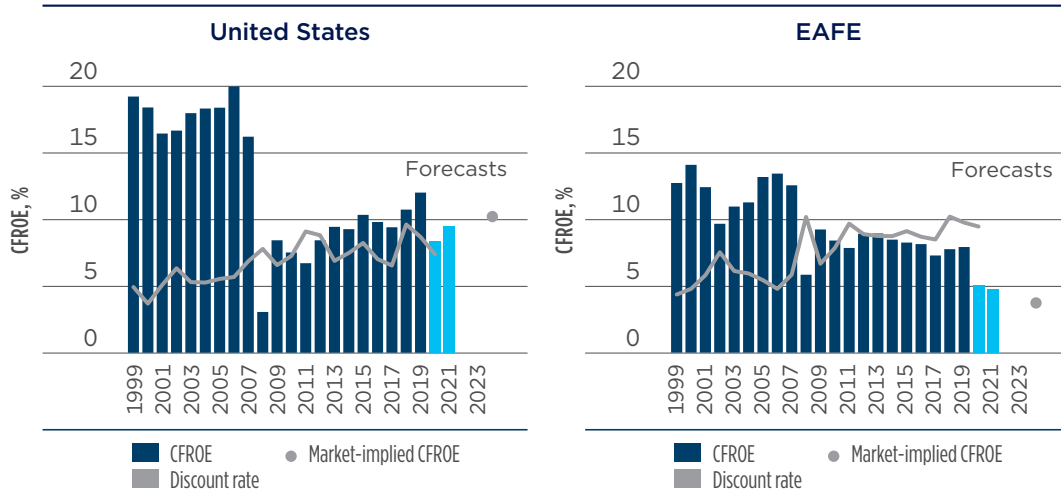


Source: Amundi as of 1 February 2021.

There are too many banks in the United States just as there were too many department stores a couple of decades ago. Most of the profits now accrue to a handful of the firms that have invested in technology and scale. **Financial services are in the early stages of a transformation that will accrue similarly excess profits to the winners.** Moreover, the advantage of the big-four US banks extends to one relative to global peers. Autonomous Research and Celent estimate that 48% of US bank technology spending is on new investment, or what they refer to as ‘change the bank’ spending, while it is only 33% for European banks. Moreover, total technology spending is approximately 13% of revenues for US banks, but only 9% for European banks. Since the end of the Great Financial Crisis (GFC), the sustained higher returns on equity of US banks vs. global peers have provided the excess capital to invest in ‘change the bank’ technology.

“Since the end of the GFC, the sustained higher returns on equity of US banks vs. global peers have provided the excess capital to invest in ‘change the bank’ technology.”

Figure 8. Diversified banks, cash flow return on equity (CFROE)

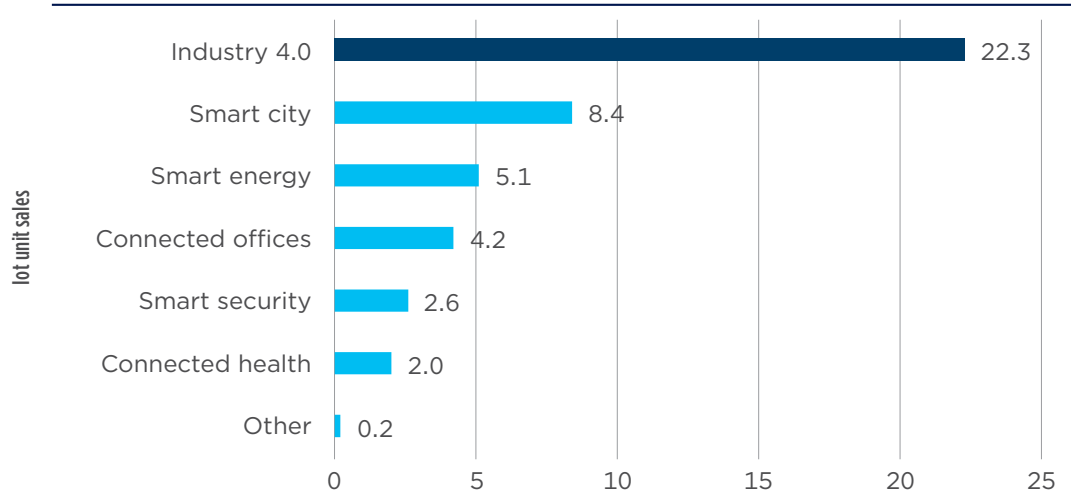


Source: Credit Suisse HOLT as of 6 January 2021. EAFE: Europe, Australasia and Far East.

2) Industrial revolution 4.0

5G and robotics are in the early stages of transforming industrials with automation and data. The emerging 5G transformation of virtually every industry based on the hyper-connectivity between people and things will enable a new era of connecting machines, with the value of these connections being the data interchange between them. The largest application of 5G will be industrials. According to McKinsey, by 2030, 22.3 million Internet of Things (IoT) unit sales of the total forecasted 44.8 million total will relate to manufacturing, construction and mining, supply chain, and agriculture. Big industrial firms in machinery and equipment, aerospace, logistics, and even waste management are going to transform their business models with connected machines and data.

Figure 9. Forecasted 5G sales, distinctive use cases, by 2030, per million units



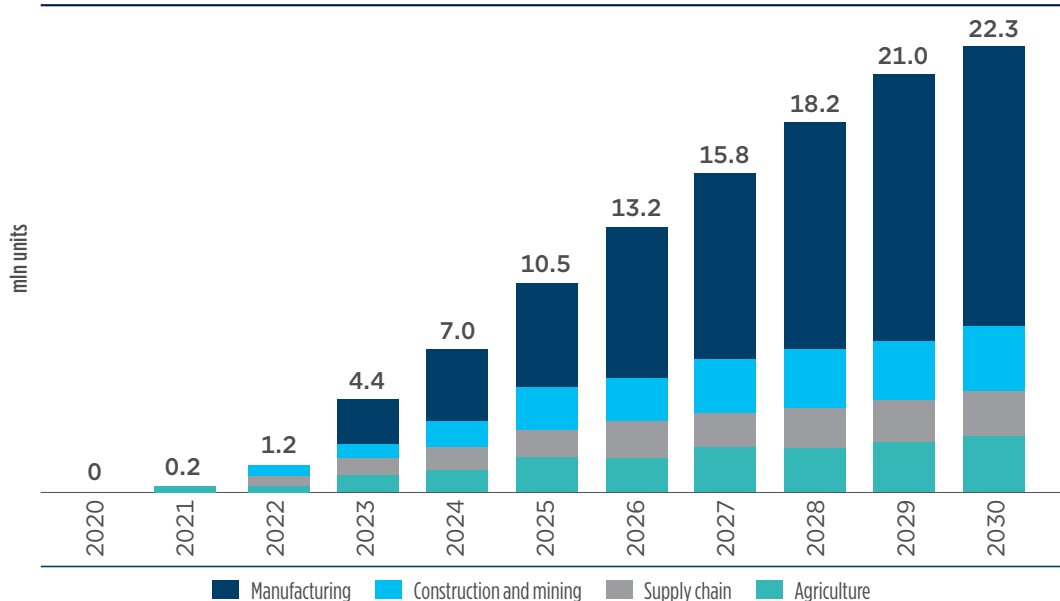
Source: McKinsey & Company, “The 5G era: New horizons for advanced electronics and industrial companies,” January 2020.

Examples of use cases:

- **Industry 4.0:** Autonomous systems in factories (e.g., robots, AGVs, computer vision, and automated or virtual-reality tools (VR) for manufacturing), smart grid control monitoring of microgeneration sites.
- **Smart city:** HD cameras for public safety and traffic management, advanced sensors for environmental monitoring.
- **Smart energy:** Smart grid control, monitoring of microgeneration sites.
- **Connected offices:** Sensor-based building management, video surveillance inside and outside buildings.
- **Smart security:** Border security, emergency services.
- **Connected health:** Mobile medical monitoring, remote surgery.
- **Other:** Smart retail (e.g., payments).

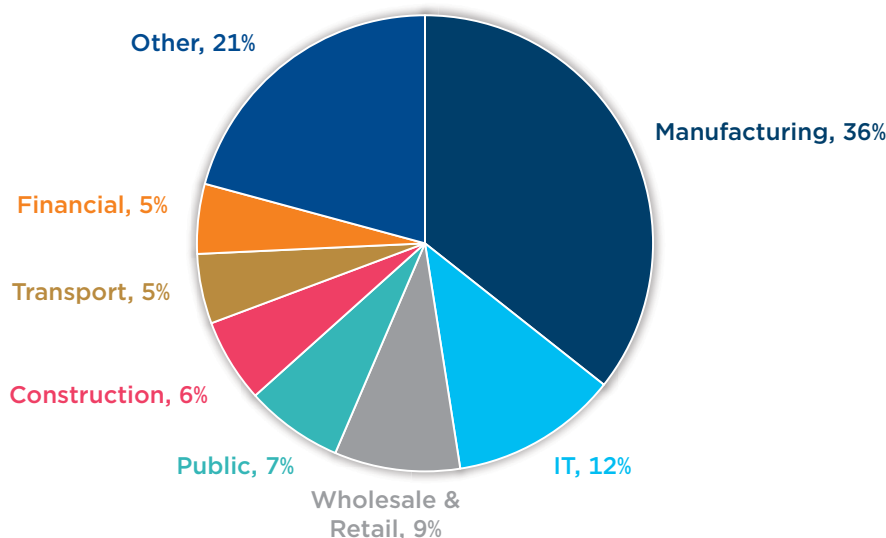
Source: McKinsey & Company, "The 5G era: New horizons for advanced electronics and industrial companies," January 2020.

Figure 10. Forecasted 5G IoT sales for Industry 4.0 applications, million units



Source: McKinsey & Company, "The 5G era: New horizons for advanced electronics and industrial companies," January 2020. IoT: Internet of Things

Figure 11. Industry output enabled by 5G in 2035

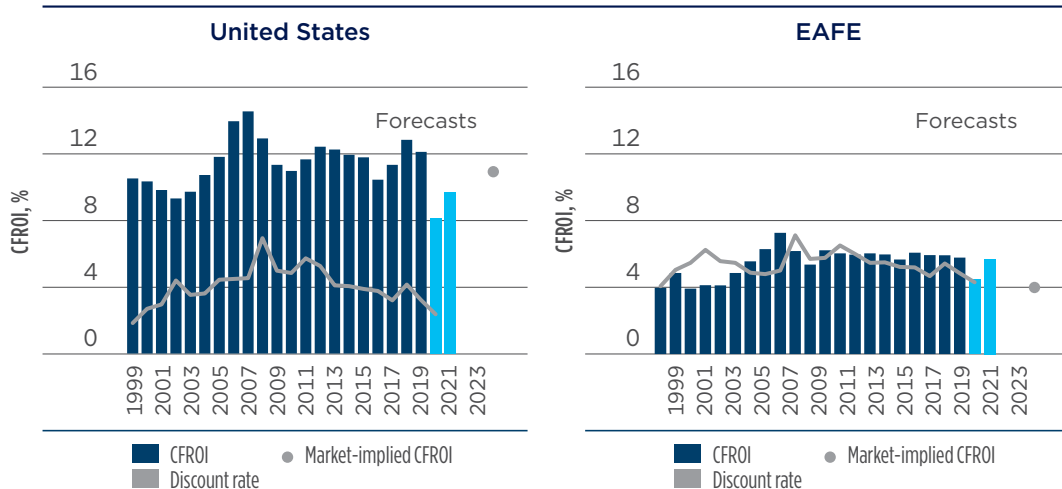


Source: IHS data and estimates as of 2 February 2021, Bernstein analysis.

“The emerging 5G transformation of virtually every industry based on the hyper-connectivity between people and things will enable a new era of connecting machines, with the value of these connections being the data interchange between them.”

Similar to financials, the meaningfully higher returns on capital have enabled an R&D and technology spending advantage.

Figure 12. US capital goods, cashflow return on investment (CFROI)



Source: Credit Suisse HOLT as of 6 January 2021. EAFE: Europe, Australasia and Far East.

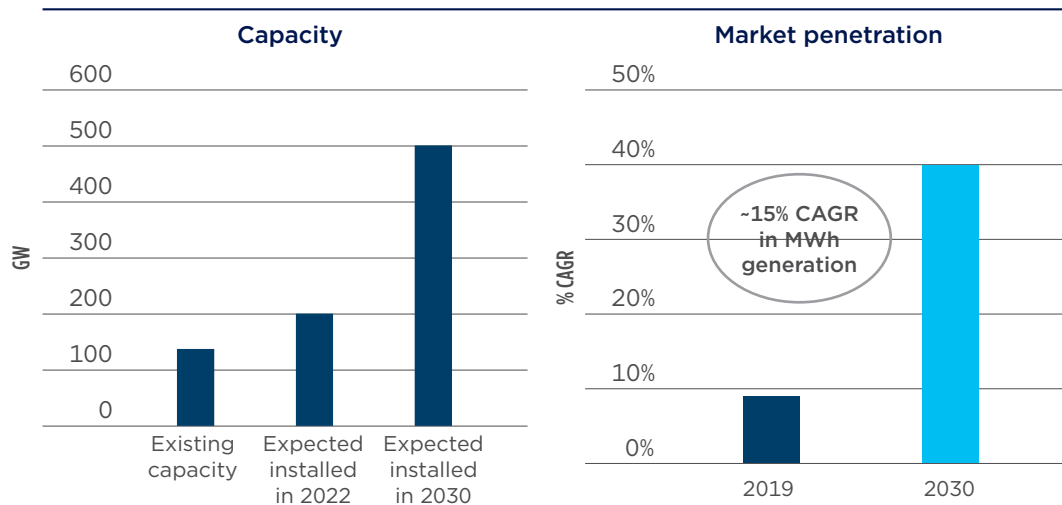
“The Utilities sector is unique among all other sectors as it has the regulated ability to invest into higher operating margins.”

3) Renewables revolution in Utilities

The United States is in the early stages of an investment cycle into economically viable renewables. Much of Europe has already converted, but in the United States we will see ten to twenty years of meaningful investment into profitable renewable projects. For most of the large US utilities, coal is being retired only when it makes economic sense, but technology is improving (e.g., fuel cells, batteries, solar) and we expect the industry’s disruptive factors to expand further and accelerate over the coming years.

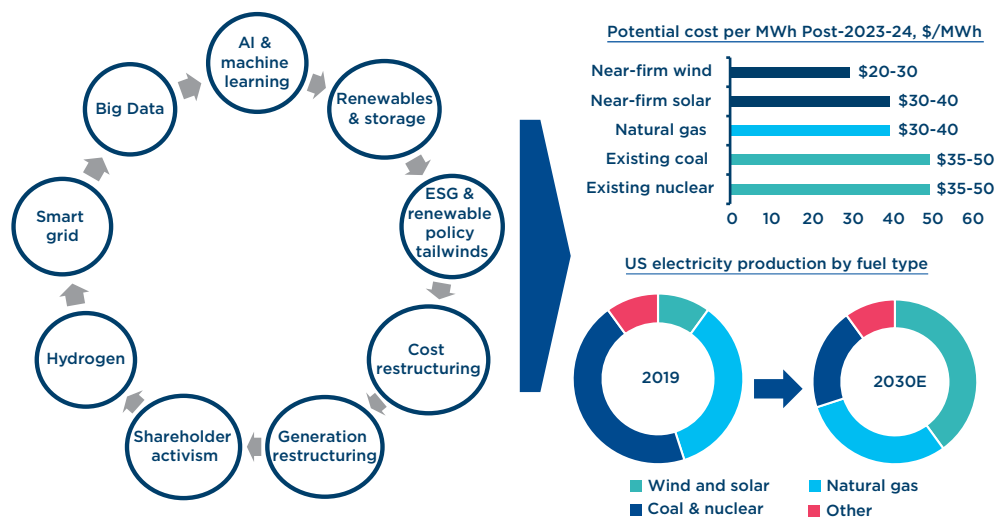
On the investment side, renewable energy capacity in the United States is forecasted to increase from approximately 137 gigawatts (GW) this year to 200 gigawatts in 2022 and 500 GW in 2030, according to the National Energy Renewable Laboratory. This will be possible as the cost of renewables declines below that of fossil fuels. We expect over \$400bn in capital expenditure for renewables over the next ten years. **The Utilities sector is unique among all other sectors as it has the regulated ability to invest into higher operating margins.** Such information may change due to any Democrat-led investment incentives that might accelerate investment.

Figure 13. US renewable energy capacity and penetration through 2030



Source: US Energy Information Administration (EIA), National Renewable Energy Laboratory (NREL). Data as of 30 September 2020.

Figure 14. US renewable energy trends ahead



Source: US Energy Information Administration (EIA), National Renewable Energy Laboratory (NREL). Data as of 30 September 2020.

History likely to repeat itself

We have historical examples to draw upon that are analogous to what will happen with technological transformations to big banks, industrials and utilities. Those examples refer to everything from the aftermath of the tech bubble to railroads, the internal combustion engine, etc.

Table 1. Technological changes throughout history

Revolution	Year	Information
	1784	Steam, water, mechanical production equipment
	1870	Division of labour, electricity, mass production
	1969	Electronics, IT, automated production
	?	Cyber-physical systems

Source: Amundi as of 3 February 2021.

In 1993, just as PCs were about to become more ubiquitous, technology was 6% of the S&P 500. In 2007, the year of the first iPhone, it was 17%. Today, including the communications services stocks that used to be in the technology sector, it accounts for 33% of the S&P 500. As technology benefits shift to the companies and industries that will revolutionise emerging tech (e.g., AI, machine learning, 5G, cloud, renewables), the big banks, leading industrials and forward-thinking utilities should do what technology has done to transform their profit pools and, more importantly, their valuations.

Nearly half of value represents stability and defensiveness

“An active manager with an emphasis on quality and the sustainability of business models will avoid deep, distressed value, where the existential risks reside.”

There is a misperception that value is full of distressed firms. We believe this is not true. **We estimate that nearly half of the large-cap value index is comprised of companies with relatively stable and/or defensive characteristics that are also structural winners more often than not.** With our view that 25% of the value universe represents a transformational technology opportunity as described above, the total that is anything but distressed or deep value is almost three-quarters of the value index. In addition, many of the firms we categorise as stable or defensive are scale industry players that will accrue similar technology benefits to market share and operating margins as we see for financials and industrials. Industries include media and entertainment, mass/discount and home improvement retail, quick-service restaurants, asset management, industrial gasses and payments. **Importantly, an active manager with an emphasis on quality and the sustainability of business models may avoid deep, distressed value, where the existential risks reside.** These include mall-based retail with no plausible e-commerce strategy, secularly challenged regional banks, energy, tobacco, airlines, office and mall REITs.

Table 2. Value companies across sectors

Sector	Value index, %	Insights
Consumer staples ex-tobacco	8%	Household & personal products, beverages and secular winner retail make up bulk of sector
Stable consumer discretionary	3%	Quick-service restaurants, home improvement retail, secular winner general discount retail
Growth real estate	1%	Logistics/warehouses, telecom towers, data centres
Communications services	10%	Broadband, wireless, search, mobile operating systems, secular winning content, video games
Healthcare	14%	Despite looming government involvement, private sector is part of the solution
Non-cyclical materials	2%	Industrial gases, water/cleaning solutions
Safe non-spread financials	4%	Auto insurers, property & casualty insurers, insurance brokers, securities exchanges, financial data providers, secular winner asset manager
Secular winners/ Survivors in tech	5%	Semiconductors, networking equipment, payment processors
Total	47%	

Source: Amundi estimates as of 31 December 2020.

US value includes the most likely group of ‘ESG improvers’

Currently, the United States lags other countries and regions in ESG, based on ESG ratings by major ratings providers. However, **we have found emerging evidence that suggests the US firms are closing the gap with best-in-class ESG firms globally**. Interestingly, the three sectors with the lowest ESG score and the largest gap with best-in-class European ESG scores are financials, industrials and utilities, just under 30% of the value index.

Table 3. ESG scores across sectors

Sector	Number of companies	Russell 1000 Value index (RLV), %	Weighted ESG Score Russell 1000 Value Index	ESG score gap between MSCI Europe and RLV
Communication services	46	9%	-0.21	1.50
Consumer discretionary	95	8%	-0.02	0.68
Consumer staples	52	8%	-0.36	1.17
Energy	34	4%	-0.35	1.18
Financials	135	19%	-0.48	1.40
Healthcare	81	14%	-0.26	1.17
Industrials	133	14%	-0.37	1.41
Information technology	92	9%	0.29	0.89
Materials	52	5%	0.37	0.32
Real estate	75	5%	0.04	1.41
Utilities	38	6%	-0.32	1.96
Grand total	833	100%	-0.22	1.16

Source: Bloomberg, Amundi estimates as of 31 December 2020. The weighted ESG score is an ESG score adjusted for the weighting of the index. The ESG score gap is the difference between the weighted ESG score of the RLV and the MSCI Europe index. The Weighted ESG score is based on Amundi's proprietary ESG rating methodology and generally ranks companies from -2.5 to 2.5, with a higher score indicating a better ESG rating.

The rationale for the improvement in ESG scores for utilities is described in detail above given the emerging transformation towards renewables.

Among financials and industrials, a meaningful driver of the poor relative ESG scores is a lack of disclosure. As discussed in our recent paper “Building ESG momentum in US equities”, improvements in ESG data and disclosures are gaining more momentum among US companies. In particular, environmental and social shareholder resolutions in the most recent 2020 proxy season garnered almost as much support as governance resolutions, twice what they were several years ago.

Moreover, the bulk of such resolutions called for greater transparency and improved disclosure. Banks provide a clear example as the large US banks lag their European peers in ESG ratings with the primary factor being climate risk. European regulations require significant disclosure of climate risks for bank operations, such as loans. Currently, the US does not have regulations to the scale of Europe, but **we expect the Federal Reserve and the Biden administration to close the regulatory disclosure gap with Europe around climate risk.**

“We expect the Federal Reserve and the Biden administration to close the regulatory disclosure gap with Europe around climate risk.”

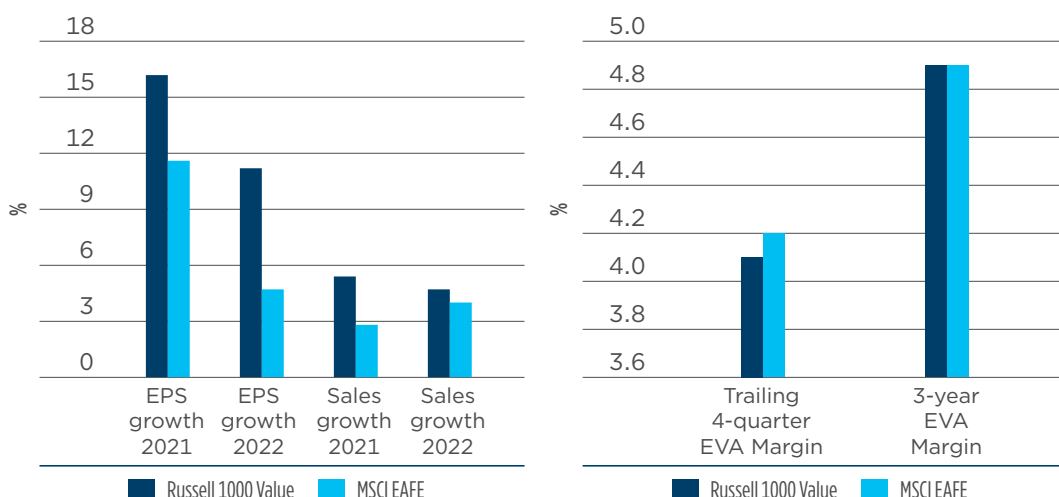
US value vs. the rest of the world: quality with appealing valuation

In 2020, we made the case that the case for US equities in global portfolios is built on the premise that unlike other markets, the S&P 500 is not particularly analogous to the US economy. We would extend that assertion partially to US large cap value. While the S&P 500 is a collection of the best and most profitable companies in the world and the US economy is not the US stock market, we observed above that **nearly three-quarters of the US large cap value universe represents secular growth, stability and defensiveness**, while the composition of value differs globally.

"US value is more profitable and cheaper than the core markets of the rest of the world (ex-United States)."

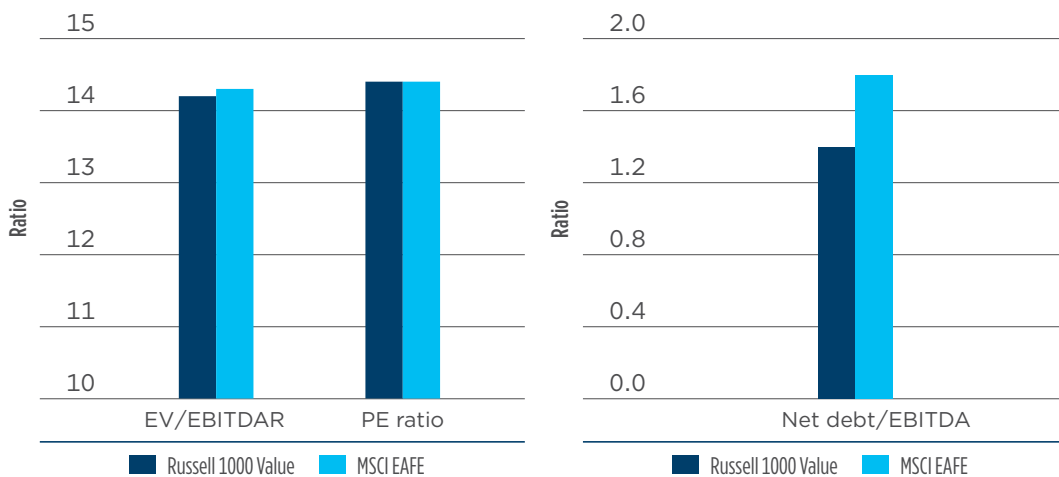
US value has been more profitable and is forecast to have higher growth in 2021 and 2022 than the core markets of the rest of the world, as shown in figure 15 where we compare the primary US large-cap value index, the Russell 1000 Value, with the MSCI EAFE. Moreover, as figure 15 demonstrates, valuation is approximately the same, while debt levels are lower. Thus, US value provides higher risk-adjusted quality and growth for the same valuation.

Figure 15. Growth and profitability comparison



Source: ISS EVA and Bloomberg. Data as of 10 February 2021. EVA Margin is EVA/sales, or profit margin of net operating profit after tax less a charge for invested capital. EAFE: Europe, Australiasia and Far East.

Figure 16. Valuation metrics and leverage comparison



Source: ISS EVA and Bloomberg. Data as of 10 February 2021.

Conclusion: the time for US value is now

“While recency bias can lead to a systematic exaggeration in any direction, it is clear to us that right now the aggregate market participants have created a powerful investable anomaly for value over growth.”

With the context that over ten-year rolling periods, value has almost always outperformed growth. However, the more recent periods in which growth has massively outperformed value have been an anomaly. **While recency bias can lead to a systematic exaggeration in any direction, it is clear to us that right now the aggregate market participants have created a powerful investable anomaly for value over growth.** We believe that conditions are budiling for a rotation towards value thanks to rebounding growth and rising bond yields on the wake of massive fiscal stimulus and ultra-accomodative monetary policy.

Again, history is likely to repeat itself

This has happened before and we cannot see why it won't again. Over the past 60 years, investors have often cited many troubling geopolitical and financial events as reasons to avoid taking the 'risk' of owning stocks, whether it was the Cuban missile crisis, the Vietnam war, the lost decade of the 1970s -- marked by double-digit interest rates, inflation and unemployment -- the 23% one-day record decline in the Dow Jones index in October 1987, the savings and loan crisis of 1990, the internet bubble bursting in 2000, the unprecedented terror attacks of 11 September 2001, the global financial crisis, and, more recently, coronavirus. Investors who missed the powerful risk-on rallies hurt their long-term returns meaningfully. On the other side are the bubbles - the 'nifty-fifty' of the early 1970s, the tech bubble in the late 1990s, and the housing bubble in the mid-2000s. Investors who enjoyed rapidly appreciating stock prices convinced many investors to keep riding out the market. This works until it does not.

Recency bias

The recent past may be fresh in one's mind, but putting it in the proper context can keep it from having an undue influence on investment performance. Recency bias -- when people extrapolate a current trend well into the future -- is one of the most powerful biases in finance. Human psychology weighs recent events and observations more heavily than those in the past. This is a version of the availability heuristic whereby people tend to base their thinking disproportionately on whatever comes most easily to mind. **In an investment context, this can be dangerous because people tend to give more credence to recent investment performance, current events and new information, disregarding the majority of the facts, valuations and the long-term picture when attempting to maximise future returns.** This is not an academic or theoretical argument; rather recency bias often leads investors to make poor decisions that can erode earning potential by tempting themselves to hold for too long what has worked and/or selling compelling value too soon.

Appendix: US value vs. growth overtime

Since 1968, there have been only seven five-year periods which showed growth outperformance. Three of them have been the most recent periods.

Table 4. US value vs. growth overtime

Rolling 5y periods	Top 20% by PE (Growth)	Bottom 20% by PE (Value)	Value outperf.	Growth outperf.	Rolling 5y periods	Top 20% by PE (Growth)	Bottom 20% by PE (Value)	Value outperf.	Growth outperf.
1968-72	6,0%	9,7%	3,7%		1993-97	14,4%	22,0%	7,6%	
1969-73	0,3%	0,0%	----flat----		1994-98	16,2%	17,8%	1,6%	
1970-74	-4,3%	1,1%	5,4%		1995-99	21,8%	18,2%		3,6%
1971-75	2,7%	12,4%	9,7%		1996-00	16,4%	13,9%		2,5%
1972-76	2,4%	17,8%	15,4%		1997-01	8,7%	13,3%	4,6%	
1973-77	-3,3%	17,0%	20,3%		1998-02		4,7%	5,0%	
1974-78	1,4%	24,7%	23,3%		1999-03	2,6%	12,1%	9,5%	
1975-79	14,4%	34,2%	19,8%		2000-04	1,5%	16,0%	14,5%	
1976-80	15,4%	34,7%	19,3%		2001-05	3,0%	15,4%	12,4%	
1977-81	9,9%	18,2%	8,3%		2002-06	9,3%	16,0%	6,7%	
1978-82	18,9%	22,2%	3,3%		2003-07	16,3%	15,8%	----flat----	
1979-83	22,5%	24,5%	2,0%		2004-08	-3,1%	0,8%	3,9%	
1980-84	15,3%	26,1%	10,8%		2005-09	1,5%	4,8%	3,3%	
1981-85	12,4%	26,5%	14,1%		2006-10	4,0%	4,8%	----flat----	
1982-86	17,2%	27,6%	10,4%		2007-11	1,3%	1,7%	----flat----	
1983-87	12,2%	18,9%	6,7%		2008-12	4,1%	4,5%	----flat----	
1984-88	9,8%	18,2%	8,4%		2009-13	21,9%	25,3%	3,4%	
1985-89	16,8%	16,3%	----flat----		2010-14	16,3%	17,7%	1,4%	
1986-90	8,6%	6,1%			2011-15	11,9%	11,9%	----flat----	
1987-91	11,7%	10,5%			2012-16	13,7%	15,3%	1,6%	
1988-92	11,9%	15,4%	3,5%		2013-17	13,6%	15,6%	2,0%	
1989-93	12,3%	14,5%	2,2%		2014-18	7,1%	3,6%		3,6%
1990-94	7,1%	10,1%	3,0%		2015-19	9,9%	6,5%		3,4%
1991-95	15,0%	23,2%	8,2%		2016-20	13,9%	7,7%		6,2%
1992-96	12,5%	17,9%	5,4%						

Source: Factset, Amundi. Data as of 31 December 2020. Data shown is annualised returns of the top 20% and bottom 20% of the S&P 500 Index by P/E ratio over five-year rolling periods, with one-year steps. Value is defined as the bottom 20% of stocks in the S&P 500 index by P/E ratio. Growth is defined as the top 20% of stocks in the S&P 500 index by P/E Ratio. Flat is when outperformance is less than 1%. **Data is based on past performance, which is no guarantee of future results.**

Definitions

- **Correlation:** The degree of association between two or more variables; in finance, it is the degree to which assets or asset class prices have moved in relation to each other. Correlation is expressed by a correlation coefficient that ranges from -1 (always move in opposite direction) through 0 (absolutely independent) to 1 (always move in the same direction).
- **Cyclical vs. defensive sectors:** Cyclical companies are companies whose profit and stock prices are highly correlated with economic fluctuations. Defensive stocks, on the contrary, are less correlated to economic cycles. MSCI GICS cyclical sectors are: consumer discretionary, financial, real estate, industrials, information technology and materials, while defensive sectors are consumer staples, energy, healthcare, telecommunications services and utilities.
- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio in an attempt to limit exposure to any single asset or risk.
- **Growth style:** It aims at investing in the growth potential of a company. It is defined by five variables: 1. long-term forward EPS growth rate; 2. short-term forward EPS growth rate; 3. current internal growth rate; 4. long-term historical EPS growth trend; and 5. long-term historical sales per share growth trend. Sectors with a dominance of growth style: consumer staples, healthcare, IT.
- **P/E ratio:** The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS).
- **Quality investing:** It aims at capturing the performance of quality growth stocks by identifying stocks with high return on equity (ROE), stable year-over-year earnings growth, and low financial leverage.
- **Russell 1000 growth index:** it measures the performance of large cap US growth stocks.
- **Russell 1000 value index:** it measures the performance of large cap US value stocks
- **Super high-growth stocks:** A high-growth stock is anticipated to grow at a rate significantly above the average growth for the market.
- **Value style:** It refers to purchasing stocks at relatively low prices, as indicated by low price-to-earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.
- **Volatility:** A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

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Date of first use: 8 March 2021.

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