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## Looking for 'Real' Value

With the recent shift in growth/value market dynamics, do participants have all the tools they need?

After many years of growth outperformance, many believe that the markets may have reached a turning point that favors value stocks. For defined contribution plan sponsors, this reinforces the need to assess value-oriented equity strategies to make sure they provide quality investment options and actually represent value characteristics. The point, in our view, is not to steer participants toward value, but rather to ensure that those who decide to invest in a plan's large-cap value option are gaining exposure through a true value manager and not one that has drifted into growth.

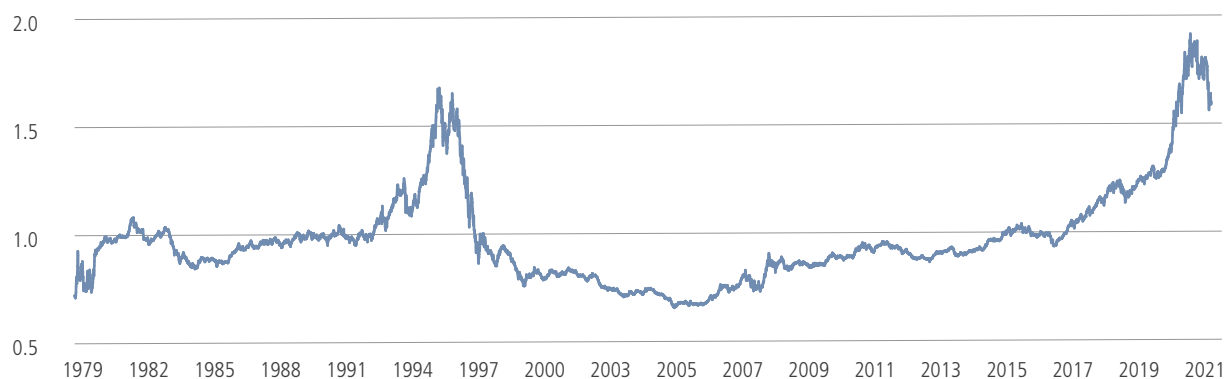
### Changing Leadership

A look at the recent past can offer perspective on current growth/value dynamics. The display below graphs the relative valuation of large-cap growth and value stocks, as represented by their Russell 1000 cohorts, which reflects the outperformance that growth has enjoyed for an extended period. As shown, although the difference has retreated from record highs, growth stocks still remain far more expensive in relation to value than at any time except the 1990s technology bubble. Although the past may not be prologue, that market was followed by a period of value investment strength in which the valuation spread narrowed by more than half.

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## VALUATION DIFFERENCE BETWEEN GROWTH AND VALUE REMAINS NEAR RECORD LEVELS

Ratio: Russell 1000 Growth Index to Russell 1000 Value Index



Source: Bloomberg as of March 31, 2021.

**Past performance is no guarantee of future results.**

A similar story may be emerging now. In the first quarter alone, value outpaced growth (again represented by Russell indices) by nearly 1,100 basis points (11.7% to 0.9%), driven by vaccine optimism and economic acceleration.

Although Q1 was an exception, it is worth considering whether value's recent advantage may continue into the intermediate or long term. Keep in mind that performance leadership between value and growth has often changed hands in the past. More specifically to the current market, we believe that two factors in particular favor value stocks.

First, both monetary and fiscal stimulus are currently being pumped into the system, and with the post-pandemic environment on the horizon, we think the economy is set to experience early-cycle conditions that have typically favored value over growth.

Second, many investors believe that inflation and interest rates could move higher—a dynamic that has typically supported value sectors such as financials, industrials and materials.

### Finding 'True' Value

As in any period when an asset class outperforms, many plan participants are likely to consider adding exposure to value in the coming months.

One important issue that remains is concentration. Large-cap stocks are now dominated in terms of market weight by just a handful of growth stocks. By extension, the large-cap indices, and many managers who follow them, are also highly concentrated. In some cases, this can even extend to large-cap value funds—creating the potential for unintended growth risk exposures in participant portfolios.

For plan sponsors, therefore, we believe it is important to conduct a thorough review of value managers to assess their exposures and their vigilance in applying value disciplines. As with any asset class, looking to historical performance patterns and the experience of managers across cycles could also be highly relevant. Sponsors should keep an eye out for style drift, and whether managers captured returns from growth factors rather than sticking to their value "knitting."

Offering plan options that can provide real value exposure can help participants as they seek to create portfolios that maximize risk-adjusted return potential. Recognizing the current opportunity associated with value stocks may be part of this process, but having strong, accurately labeled value managers will likely be another.

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#### INDEX DEFINITIONS

**The Russell 1000 Value Index** measures the performance of those Russell 1000® Index companies with lower price-to-book ratios and lower forecasted growth values. The index is market cap-weighted and includes only common stocks incorporated in the United States and its territories.

**The Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

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