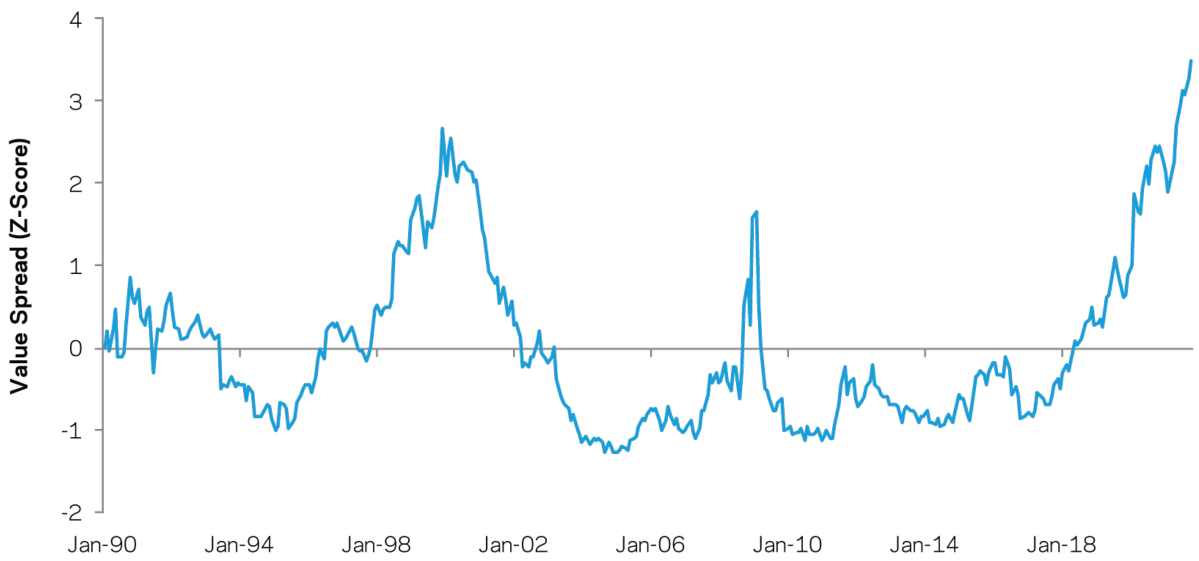
Value

That's It, That's the Blog [1]

December 16, 2021

Global Value Spreads
Hypothetical AQR Industry-and-Dollar-Neutral All-Country Value Portfolio[2,3,4,5]



Source: AQR. January 1, 1990 – November 30, 2021.

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[1] Hopefully the single graph/blog is pretty self-explanatory. And, of course, there are some footnotes, so it's really not the whole blog…

[2] Spreads are constructed using a hypothetical AQR value composite that includes five value measures: book-to-price, earnings-to-price, forecast earnings-to-price, sales-to-enterprise value, and cash flow-to-enterprise value. Spreads are measured based on ratios and are adjusted to be dollar-neutral, but not necessarily beta-neutral through time. To construct industry-neutrality, the value spreads are constructed by comparing the value measures within each industry. The all-country universe is based on roughly 70% developed / 30% emerging weights, derived based on proprietary ex-ante risk targets as of 11/30/2021. The developed data starts January 1990, while the emerging universe is included starting December 1994. The risk models used are the Barra Developed Equity Risk Model and Barra Emerging Equity Risk Model. Hypothetical data has inherent limitations, some of which are listed in the Disclosures. For illustrative purposes only and not representative of an actual portfolio AQR currently manages. Please read the Disclosures for important information.

[3] Over the last few years, we've calculated the value spread various ways in these blogs. Sometimes just in the USA. Sometimes using only one measure like P/B when we want to go really far back in time. What we present here is the closest yet to how we actually view value and represents the value spread we look at most often in making decisions about tilts and the like. Other variants may differ somewhat. For example, the value spread is extremely wide in the USA (whose valuations are most often tracked) but not as extreme as in emerging markets (whose 30% weight exceeds the global market-cap weight because we see greater long/short opportunities there). Though, frankly, the USA-only graph would still be pretty incredible :). Also, the spread has come in a tad in December (as of this writing – not guaranteed when you read it!) along with value doing well, but it doesn't change the graph above more than a smidgen.

[4] And yes, such a spread says little about timing. When it will work is not a question that has escaped us! A common question is "what's the catalyst." I look back at times like the peak in March of 2000 (tech bubble) and note that 21 years later we still don't know what the catalyst was for it stopping there. But, while timing will always be bedeviling, we do believe the odds get better the crazier prices get, and the medium-term expected returns get better too.

[5] Note, our value factors are generally up on the year (2021) despite value spreads exploding higher. While it's normal for value spread widening to lead to value losses (and vice versa) it is a strong but a not perfect relationship. In particular, based on turnover in what constitutes value (e.g., if whatever changes occur naturally in the dynamic value portfolio lead to wider spreads) and changes in fundamentals (e.g., if cheap stocks deliver better relative fundamental performance than growth stocks), the value spread can widen (as value looks cheaper vs. better fundamentals and vice versa) without a change in price. But, the bottom line, as usual, is there are no guarantees (particularly over the short term), but making some money on value this year while it's gotten way cheaper (and record cheap) is not a bad combination and has us very excited for 2022 and beyond.