Value Investing and Monetary Policy

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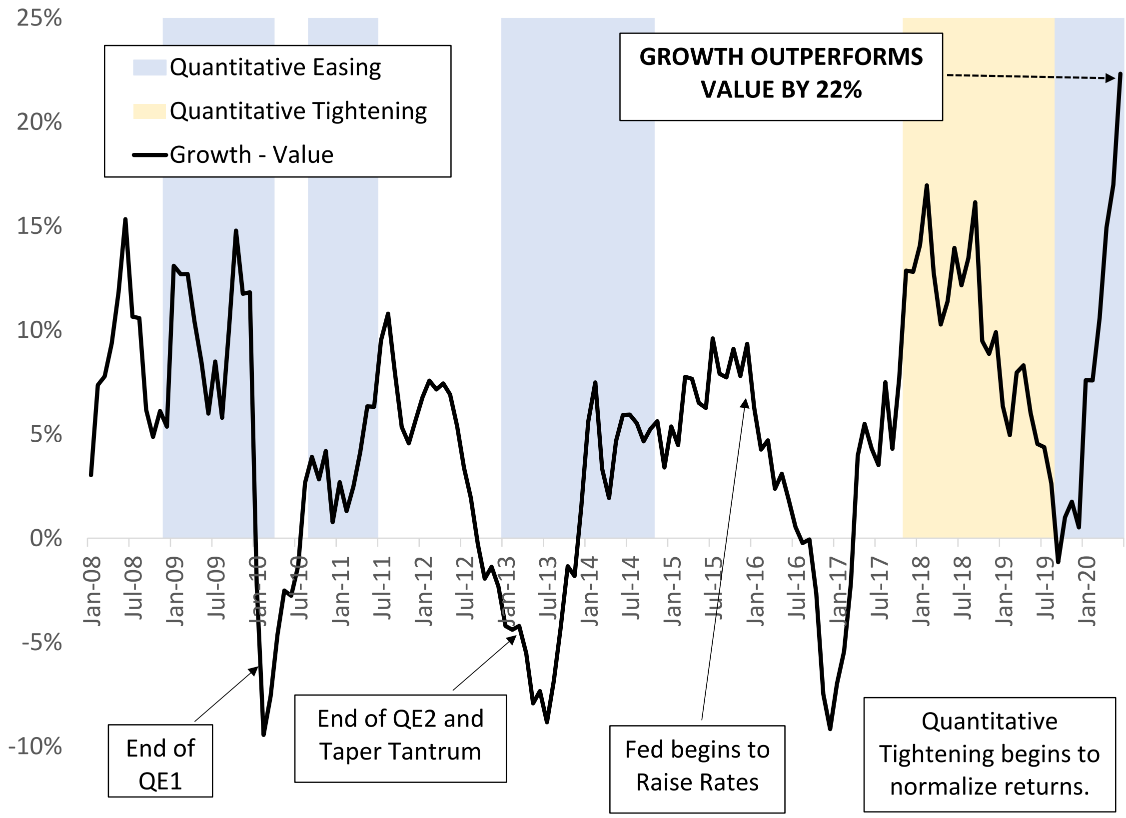
Jason Zweig's "The Bull Market Isn't As Big as You Think" in *The Wall Street Journal*[1] nicely illustrates how the stock market may not be as disconnected from economic reality as many suspect - due to large performance disparities closely mirroring real world sectoral shifts. The piece ends with cautious optimism that cheap value stocks will ultimately outperform their more expensive growth counterparts – as they have over decades.

However, the piece misses the monetary elephant in the room. Yes. "Seldom has the gap between the [stock valuation] haves and the have-nots been as wide as it is now." Yet, seldom has monetary stimulus been such a game changer for investor incentives.

Figure 1. Monetary Expansion favors Growth and hinders Value



Source: Standard & Poors' Growth and Value Indexes, Bloomberg, LP, and Center for Financial Stability.

Since the introduction of Quantitative Easing (QE), value investing only outperformed growth strategies during four brief moments – as measured by S&P Value and Growth Indexes. Not surprisingly, **the relative outperformance of value versus growth strategies coincided with**

[1] Zweig, Jason, The Bull Market Isn't As Big as You Think, The Wall Street Journal, June 5, 2020.

periods when the Fed curtailed its injections of monetary liquidity: 1) the end of QE1, 2) end of QE2, 3) end of QE3, and 3) the period of quantitative tapering.

It is no wonder that with a $3 trillion expansion of the Fed's balance sheet the relative outperformance of growth over value advanced from near zero at the beginning of 2020 to 17% by the end of May.

Although the monetary policy response to the Coronavirus was needed, unintended distortions should be acknowledged and incorporated into future actions.

The implication for value investors is clear. Monetary largess is wreaking havoc with the investment strategy. For the public and officials, the propagation of valuation distortions starve a wide spectrum of deserving companies and industries access to capital. This will surely minimize private sector driven growth going forward.