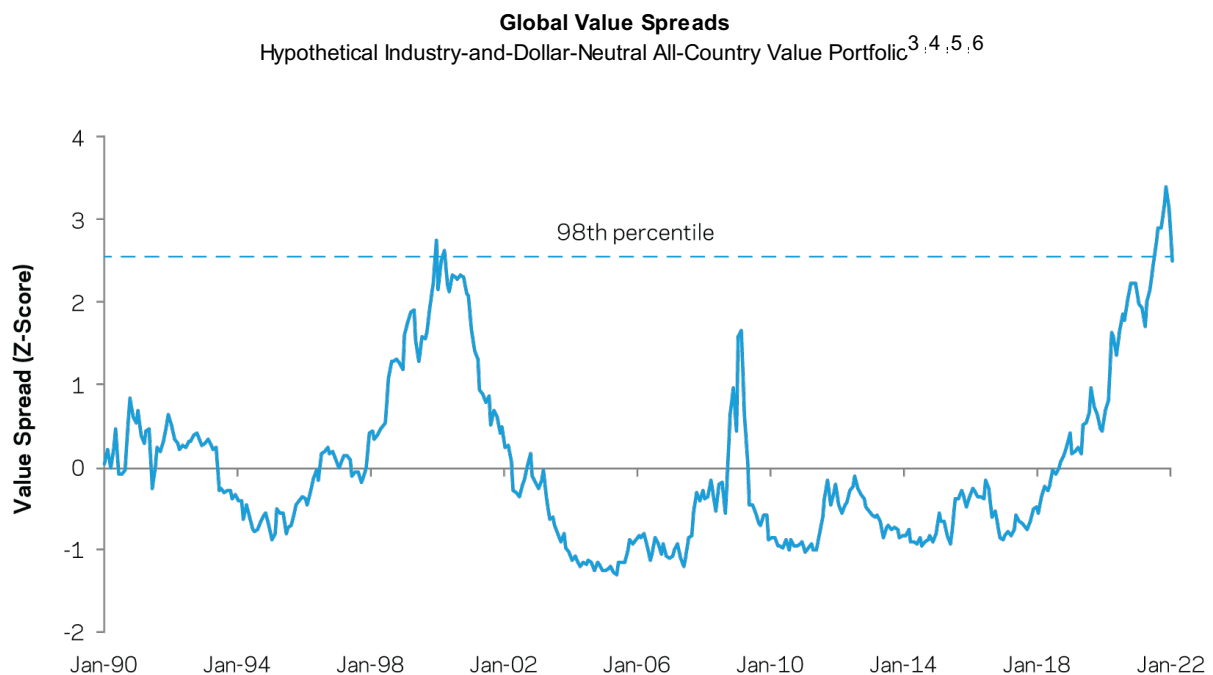


FACTOR / STYLE INVESTING

That's It, That's the Update^{1,2}

February 4, 2022



Source: AQR. January 1, 1990 – January 31, 2022.

[1] This updates the graph from [December's blog](#), adding the next two months. Other than this footnote, the rest of the footnotes are carried over from the prior blog. Over these additional two months, value's returns, as we measure them, have been incredibly strong. This has crushed the value spread I blogged about as of the end of November 2021. And, by "crushed" I mean it's now about as high as it was at the peak of the tech bubble. Just not as high as a few months ago. Yes, "crushed" was sarcasm. Reminder — a massive valuation dislocation says very little about the timing of when it falls back to earth. But it's nice to see it start and still leave the spread incredibly high.

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

[3] Spreads are constructed using a hypothetical 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 80% developed / 20% emerging weights, derived based on proprietary ex-ante risk targets as of 1/31/2022. 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.

[4] 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. 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 20% 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 :).

[5] 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 nearly 22 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.

[6] Note, value factors were generally up in 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 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 last year while it's gotten way cheaper (and record cheap) is not a bad combination and has us very excited for 2022 and beyond.

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