BNY | INVESTMENTS

A STYLE (VALUE) FOR ALL SEASONS

Discover how value investing can bring balance to a portfolio without sacrificing performance.

INVESTMENT INSIGHTS
FROM OUR PARTNERS AT NEWTON INVESTMENT MANAGEMENT

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KEY POINTS

1 In our view, normalization in the macroeconomic environment should lead to normalization in relative performance between growth and value stocks.

2 Even in periods of multiple contraction for growth stocks, multiples for value stocks have remained relatively flat, suggesting a certain degree of downside risk mitigation.

3 Allocating to value could offer investors diversification and help minimize the impact of a market drawdown while also participating in the market's upside.

A common question from investors may be, "When should I start to consider value stocks?" At Newton Investment Management, this is one of the most frequently asked questions we have received thus far in 2024.

Earlier this year, the question was usually raised in the context of the robust market leadership of large-cap growth stocks, which saw share prices and valuations pushed to levels reminiscent of the late 1990s tech bubble. More recently, since the start of the third quarter of 2024, markets saw a reversal in the relative performance of growth versus value, akin to 2022, when the Russell 1000® Value index substantially outpaced the S&P 500® and Russell 1000® Growth indices.

Money in Motion

For a more constructive response to the question above, we would need to identify catalysts that could unseat growth and shift market leadership. A question to consider might be, "What prompts money in motion?" Historically, this has been achieved through macroeconomic data and monetary policy, major geopolitical events, a global financial crisis and a global pandemic, among other phenomena.

Everyday financial metrics such as company valuations rarely effect market-leadership changes. In our view, valuation is a poor market-timing tool — expensive stocks can stay expensive, or get more expensive, and cheap stocks can stay cheap, or get cheaper. In a "Goldilocks" environment, valuations tend to take a back seat to exuberance and matter less, until they matter more.

Hindsight is 20/20

In Newton's experience, one of the most effective ways to spot a market turn is through hindsight. For this reason, we believe that rebalancing is imperative and that allocating to value stocks may be practical in various market environments. Newton is not a proponent of market timing, nor do we look for an edge in the macroeconomic environment.

The firm focuses more on microeconomic factors, including fundamental company research, to inform the macroeconomic views that flow into our investment and portfolio-construction decision-making. Newton embraces skepticism and concentrates on durable change on the margin. For instance, if a company discloses that its costs have been incrementally rising, and we discover that its peers are echoing a similar sentiment, we can infer that costs are climbing for a broader swatch of companies and consumers. This approach gives us a direct read into inflation trends occurring throughout the broader economy. While perhaps backward looking, Newton believes these direct observations can serve as better indicators than the retroactive, key economic data preferred by the Federal Reserve (Fed). Fed Chair Jerome Powell's "transitory" inflation remarks back in 2021, which we believe did not pan out as expected, are a case in point.

If the Newton team lacks an edge, or the will to time the market, then why do we believe that value has potential in all market cycles? In our view, the following reasons support our case.

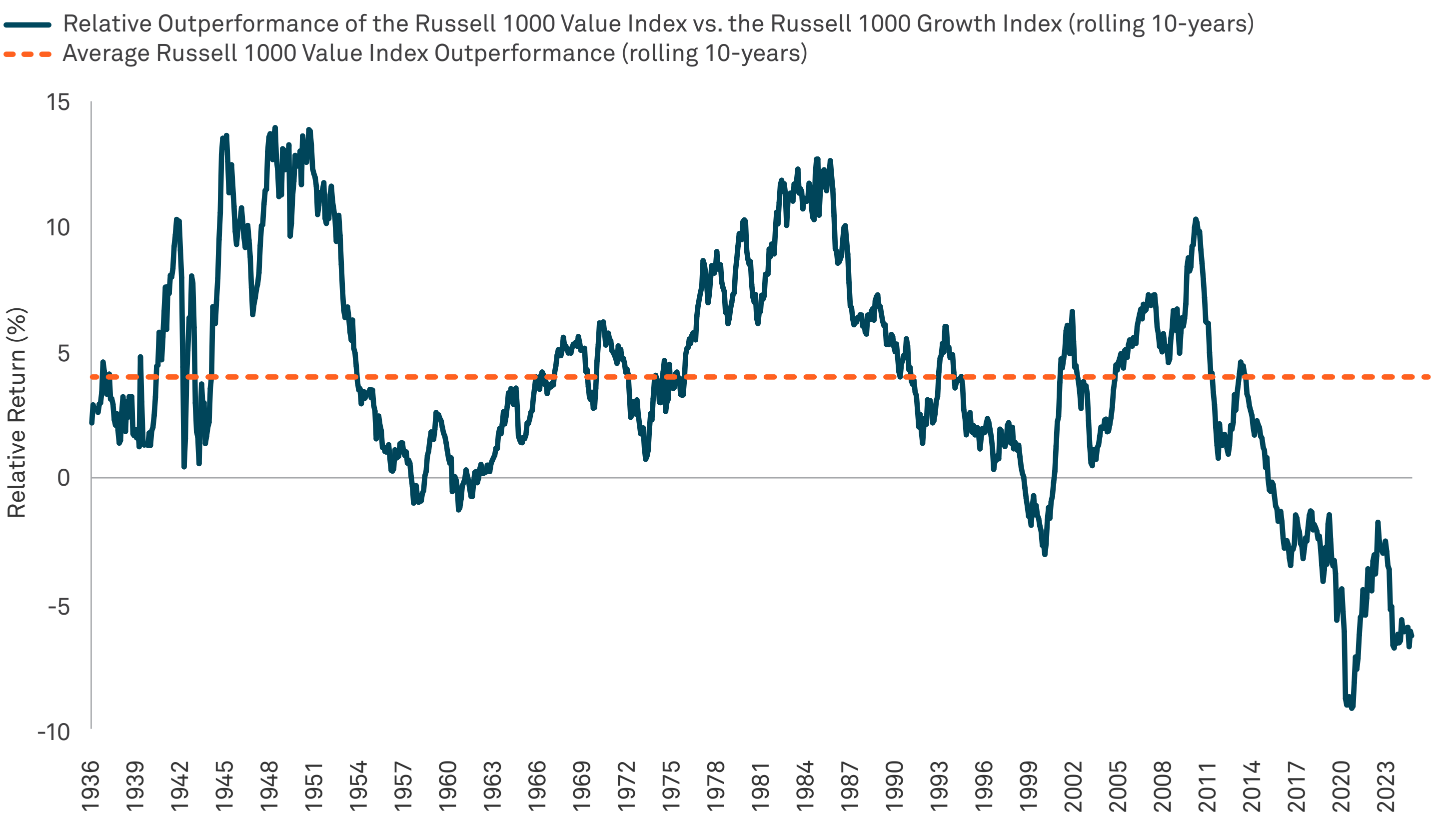
1 We believe that normalization in the macroeconomic environment should lead to normalization in stock-market performance.

First, we believe that mean reversion theory, also known as reversion to the mean, should play out as the macroeconomic environment normalizes. Over the last 90 years, value has outperformed growth on a rolling 10-year basis by roughly 400 basis points, as depicted by the dotted orange line in the chart below. Within this time frame, we have seen multiple market cycles, recessions, soft patches, booming economies, bull markets, bear markets, etc., arise. Notably, in the last 15 years, growth materially outpaced value. In our view, the robust performance of growth stocks over that period was largely driven by extremely accommodative monetary policy and quantitative easing — in other words, free money — put in place following the global financial crisis to stabilize the financial system and the global economy.

As the macroeconomic environment has begun to normalize to pre-global financial crisis levels, monetary policy has become more restrictive and quantitative easing has been replaced with quantitative tightening. Namely, the era of free money appears to have come to an end. We believe this development could be a catalyst that brings the relative performance of value versus growth closer to historical averages, though this may take some time to materialize.

> We do not expect value to outperform growth at levels seen in 2009, the mid 1980s, or the late 1940s and early 1950s. However, we do believe that as the macroeconomic environment normalizes, so should relative performance.

RELATIVE RETURN OF VALUE TO GROWTH



For illustrative purposes only. Past performance is no guarantee of future results. Sources: BNY Investments, Alliance Bernstein, as of 9/24/2024. Charts are provided for illustrative purposes and are not indicative of future performance of any BNY product. An investor cannot invest directly in an index.

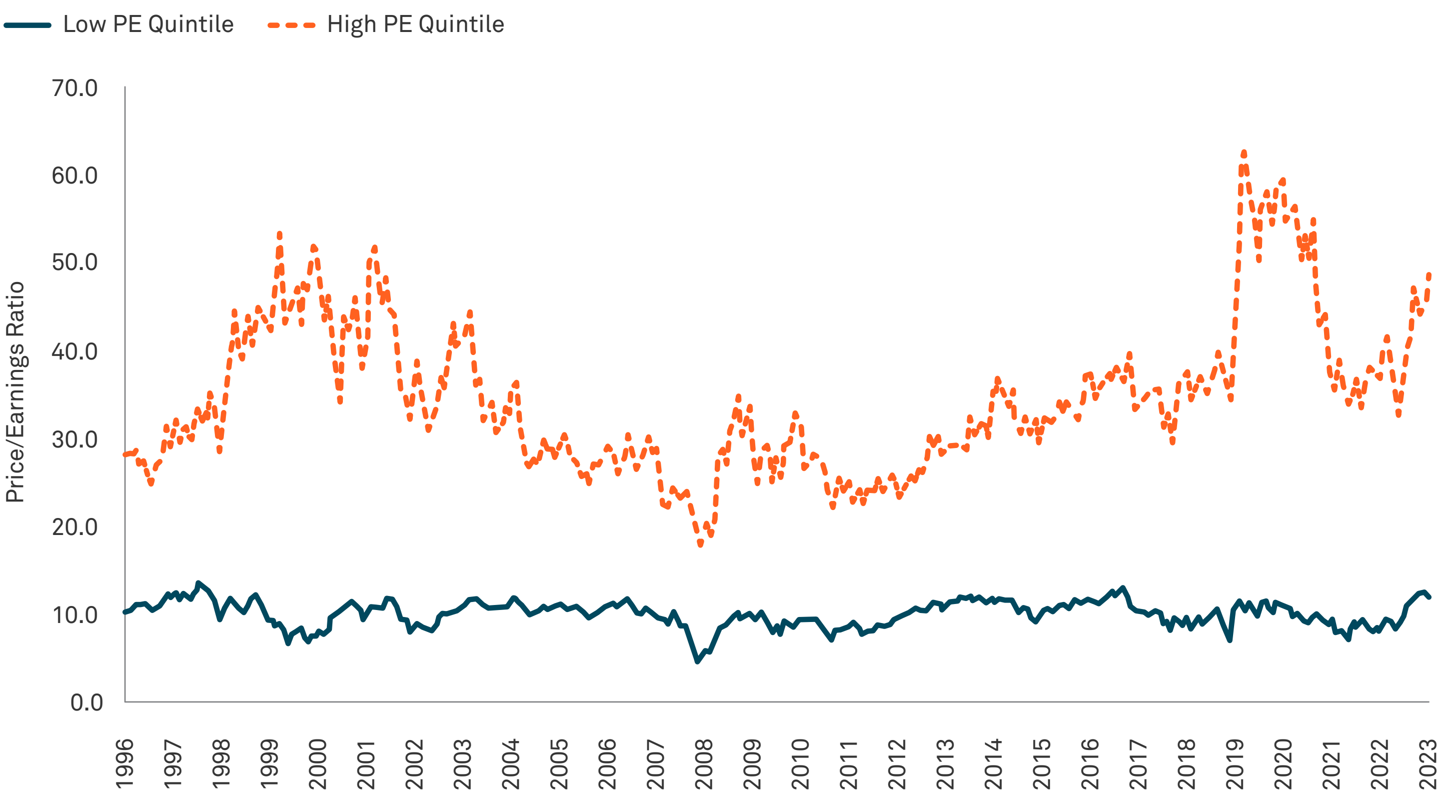
2 "Expensive" stock prices are getting more expensive.

Another reason we believe investors should consider allocating to value is because value stocks can bring balance to a portfolio. Value stocks are relatively less expensive than growth stocks, with lower price-to-earnings (P/E) ratios; yet they may still be solid investments. A P/E ratio can be a useful barometer for determining what factors the market is pricing into a company's stock price from an earnings-power perspective. Value stocks are often considered cheap, while growth stocks are typically pricier, as investors tend to bid up prices of growth stocks to get ahead of their greater earnings-growth prospects.

The chart below shows the gap between the most expensive and least expensive quintiles of stocks in the S&P 500®, as measured by their P/E ratios. As the chart illustrates, there have been periods in time when expensive stocks have become more expensive relative to both cheap stocks and their own history. For instance, expensive stocks recently begun to approach highs akin to the 1990s dot-com bubble, which may be largely driven by investor exuberance around the "magnificent seven" group of large-cap growth tech stocks and the disruptive potential of artificial intelligence. However, it is important to note that when expensive stocks have skyrocketed historically, they often later experienced multiple contractions (i.e., lower P/E levels), as waning enthusiasm caused share prices to retreat.

The remarkable consistency of cheap stocks over the same period is also noteworthy. While cheap stocks look cheap relative to pricier stocks, they also continue to look cheap relative to their own history. Even in periods of multiple contraction for expensive stocks, multiples for cheap stocks have remained relatively flat, suggesting a certain degree of risk mitigation.

EXPENSIVE STOCKS ARE LOOKING EXPENSIVE



Sources: Newton Investment Management, FactSet, as of June 30, 2024. **Past performance is no guarantee of future results.**

3 Growth and value investing is not a zero-sum game.

We also believe that allocating to value could make sense due to the changing dynamics of the risk-reward ratio between growth and value since the Covid-19 pandemic. In the ten years leading up to the pandemic, growth was the clear market leader, as accommodative monetary policy and the Fed gave investors the confidence to "buy the dip" during periods of market volatility. As the table below shows, growth delivered an impressive 15.2% annualized return while experiencing relatively mild average drawdowns of 7.6%. Based on our conversations with investors and clients, the consensus view was that value performance during this time was flat at best and negative at worst. Yet, over the same period, value delivered an annualized return of 11.8%, a respectable absolute return in our view. However, we do understand the sentiment, as value lagged growth by over 300 basis points on a relative basis.

	PRE-PANDEMIC		POST-PANDEMIC	
Index	**Total Return**	**Average Drawdown**	**Total Return**	**Average Drawdown**
Russell 1000 Growth	15.20%	-7.60%	12.90%	-13.10%
Russell 1000 Value	11.80%	-8.10%	11.40%	-9.60%

Sources: Newton Investment Management and Morningstar, as of August 31, 2024. **Past performance is no guarantee of future results.** Pre-pandemic: 1/1/2010 to 12/31/2019; post-pandemic: 1/1/2021 to 7/31/2024.

Since the pandemic, and the shift in both the macroeconomic environment and monetary policy, value has so far closed the gap. While growth has still outperformed, the margin has been cut in half. More notable, perhaps, are the drawdown statistics; over this period, the average drawdown for value is nearly 400 basis points less than that of growth.

Circling back to our previous remarks on the multiple-contraction potential of expensive growth stocks, we see that allocating to value could offer investors some diversification and help minimize the impact of a market drawdown on a portfolio while still participating in the market's potential upside.

A Balanced Approach

Since the beginning of this year, we have advocated for taking a balanced approach to investing. This was predicated on the rising uncertainty around several macroeconomic factors including economic growth, inflation and monetary policy, all of which could bring heightened volatility to markets and investor returns. We believe the same logic applies when constructing holistic investment portfolios, favoring a reasonable balance between growth and value stocks, particularly against the current backdrop of rising valuations and concentration risk among growth indices and benchmarks.

Identifying Idiosyncratic Opportunities

From a value-investing perspective, we refer to "balance" as accounting for and neutralizing macroeconomic risk, while relying on our investment process to identify compelling idiosyncratic opportunities. We continue to lean on our strengths and strive to be good stock pickers, while minimizing unintended and uncompensated risks.

Pulling back from the immediate term, we continue to believe that companies and investors alike are adjusting to the normalization of both inflation and interest rates in the US, not to pre-Covid levels but to pre-global financial crisis levels. In our view, inflation is likely to be higher and more persistent than it was in the 12 years leading up to the pandemic, and as a result, the Fed may keep interest rates elevated. While inflation has moderated from peak levels and is headed in the right direction, and while monetary policy is likely to follow, we firmly believe that the days of benign inflation and free money are behind us. In the future, we believe that fundamentals, valuations, and the ability to generate in-house liquidity via solid free cash flow should play a larger role in separating the winners from the losers. As always, we favor companies sitting at the nexus of strong and improving fundamentals, attractive valuations and catalyst-driven business momentum.

All investments involve risk, including the possible loss of principal. Certain investments involve greater or unique risks that should be considered along with the objectives, fees, and expenses before investing.

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[1] This information has inherent limitations and is being provided with the benefit of hindsight. Prevailing market conditions may be materially different from historical market conditions and may produce materially different results from those shown here. Past performance is no guarantee of future results.

A **growth stock** generally have higher price to earnings (P/E) and price to book (P/B) ratios than the S&P 500 Index; **value stocks** generally have lower P/E's and P/B's than the S&P 500 Index. **Price-to-earnings (P/E)** is the ratio of the market price of a firm's common stock to its current (or predicted) earnings per share. **Price-to-book value (P/B)** is a ratio used to compare a stock's market value with its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value (assets minus liabilities). **Mean reversion theory** is a financial theory that is grounded in the belief that asset prices and historical returns will gravitate toward a long-term average over time. **Quantitative easing** is a form of monetary policy in which a central bank, like the US Federal Reserve, purchases securities through open market operations to increase the supply of money and encourage bank lending and investment. A **drawdown** is an investment term that refers to the decline in value of a single investment or an investment portfolio from a relative peak value to a relative trough.

The **S&P 500® Index** is widely regarded as the best single gauge of large-cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. The **Russell 1000® Value Index** measures the performance of the large-cap value segment of the US equity universe. It includes those Russell 1000 companies that are considered more value-oriented relative to the overall market as defined by Russell's leading style methodology. The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. **The Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000 companies with higher growth earning potential as defined by Russell's leading style methodology. The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. Investors cannot invest directly in any index.

The "Magnificent Seven" stocks are a group of the most influential companies in the US stock market. This term has been popularized to describe a set of dominant companies, particularly in the tech sector. The group comprises Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla, and spans four sectors: technology services, electronic technology, retail trade, and consumer durables.

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