

The Value Premium

Investors building passive, beta-based portfolios should overweight value and underweight growth. By Craig L. Israelsen

NATURE VS. NURTURE, VALUE VS. GROWTH.... These are the endless questions of life. I don't have the right data to tackle the nature/nurture argument, but I will try my hand at the value vs. growth discussion.

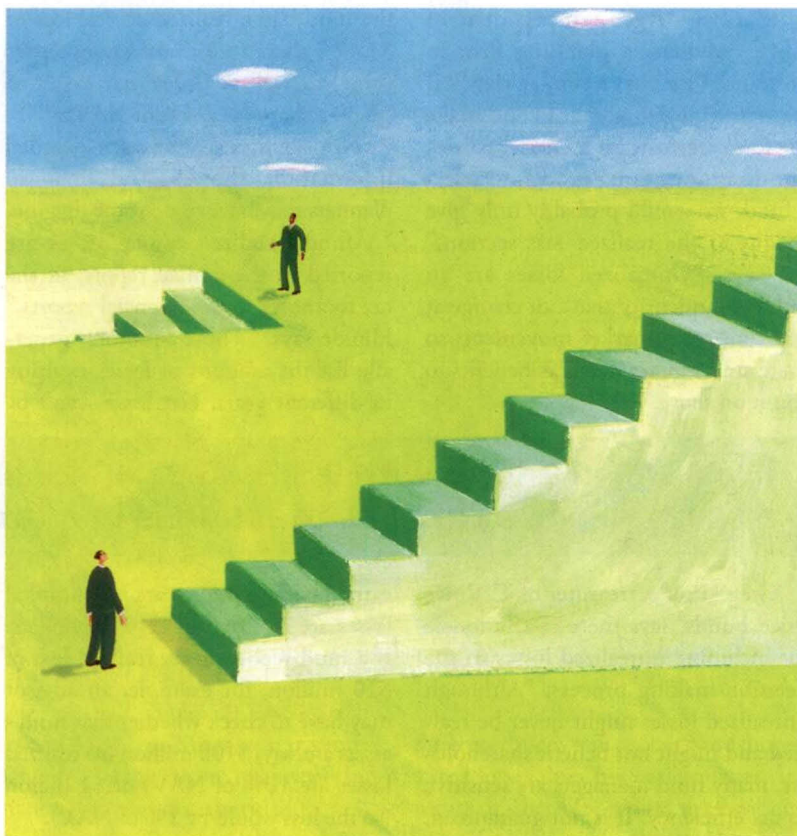
Which style has rewarded domestic investors the most, even in recent history? The answer is value, and this article quantifies the value premium among all three sizes of domestic equity indexes—large-cap equity indexes, mid-cap equity indexes and small-cap equity indexes—over the 29-year period from 1980 to 2008. So while industry experts might be trumpeting growth as the place to be when the market rebounds, advisors should remember that longer-term, the market values value, at least in passive portfolios.

A BROADER LOOK

First, let's examine the long-term performance of cash, bonds and equities. Over the 29-year period from 1980 to 2008, the S&P 500 returned 10.7% annually with a standard deviation of 18%. An initial investment of \$10,000 in 1980 grew to \$191,473 by the end of 2008 (not adjusted for taxes or inflation and assuming no additional deposits or withdrawals).

The return of three-month Treasury bills was 6%, with an annualized standard deviation of 3.45%. A similar investment of \$10,000 in 1980 grew to \$54,187.

The Barclays Capital (formerly Lehman Brothers) Aggregate Bond Index had an 8.9% annualized return with a 7.25% standard



deviation. An initial investment of \$10,000 in 1980 led to a final account value of \$118,117.

SIZE DOESN'T MATTER

Next, let's look at the returns of the six dominant style boxes (large growth, large value, mid-growth, mid-value, small growth and small value). Large-cap funds showed the smallest value premium. The 29-year annualized return of growth-oriented large-cap equity indexes was 8.9% (which represents the average of the Dow Jones Large Growth Index and the DJ Wilshire Large Growth

Index), exactly the same return as the Barclays Capital Aggregate Bond Index. By contrast, the two value-oriented large-cap equity indexes in this study returned 11.4%, on average, over the period from 1980 to 2008. In the aggregate, large-cap value generated a 255-basis-point premium over large-cap growth during this 29-year period. This value premium amounted to a differential in the final account value of more than \$113,000.

The value premium was higher in the mid-cap sector. The average 29-year return of the two mid-cap

