Index Insights

Russell US Indexes

FTSE Russell

Trends in growth and value: Cycles and market regimes

Part 2: Style intensity

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Overview

After fifteen years of striking growth dominance, the return of value style premia from deep hibernation underscores the strength and impact of market undercurrents. Indeed, the original Russell Style Indexes introduced in 1986 provide an elegant means to capture these tidal forces within the broader market. This segmentation along the lines of growth and value involves only three intuitive data inputs—namely price to book, historical earnings growth and expected earnings growth—yet it produces powerful results.[1]

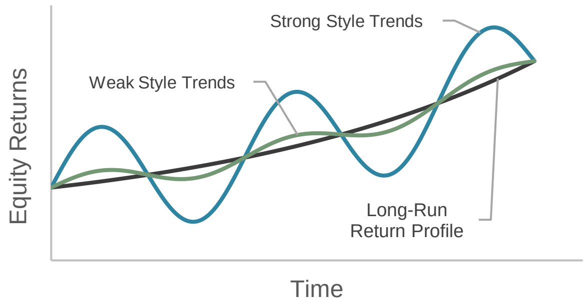
This analysis is the second in a four-part series, which breaks down the dynamics of growth and value cycles in market returns, the first of which examined the duration of the 9 style regimes since 1979.[2]

The core question this paper investigates centers on just how impactful these style trends have been historically—we examined the longevity of style trends, but what is their magnitude? Are style difference mere ripples amidst the oceanic scale of market returns, or forceful gyrations whose churn impacts all industries? Figure 1 helps visualize this distinction as we uncover the materiality of style trends.

[1] For a full overview of Russell 1000 Growth and Value Style Index construction, please refer to the Russell methodology guide here.

[2] Trends in growth and value: Cycles and market regimes - A four-part analysis [FTSE Russell].

Figure 1: Visualizing strong and weak style trends



Are style trends vigorous tides for investors to ignore at their peril (blue line) or subtle gradients in return profiles (green line)? This is the central question asked by this analysis. For illustrative purposes only.

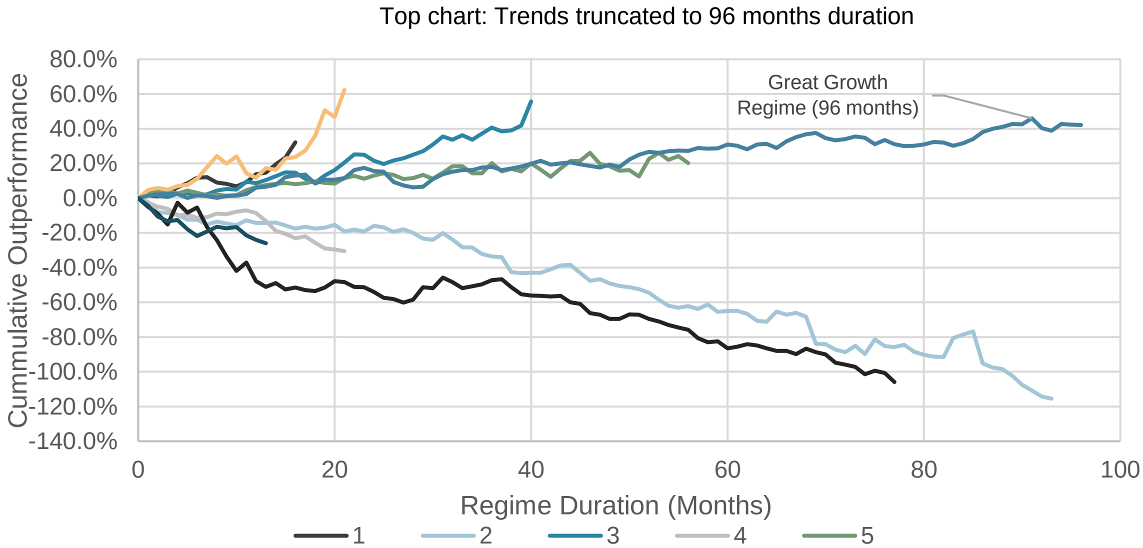
Source: FTSE Russell, February 2023.

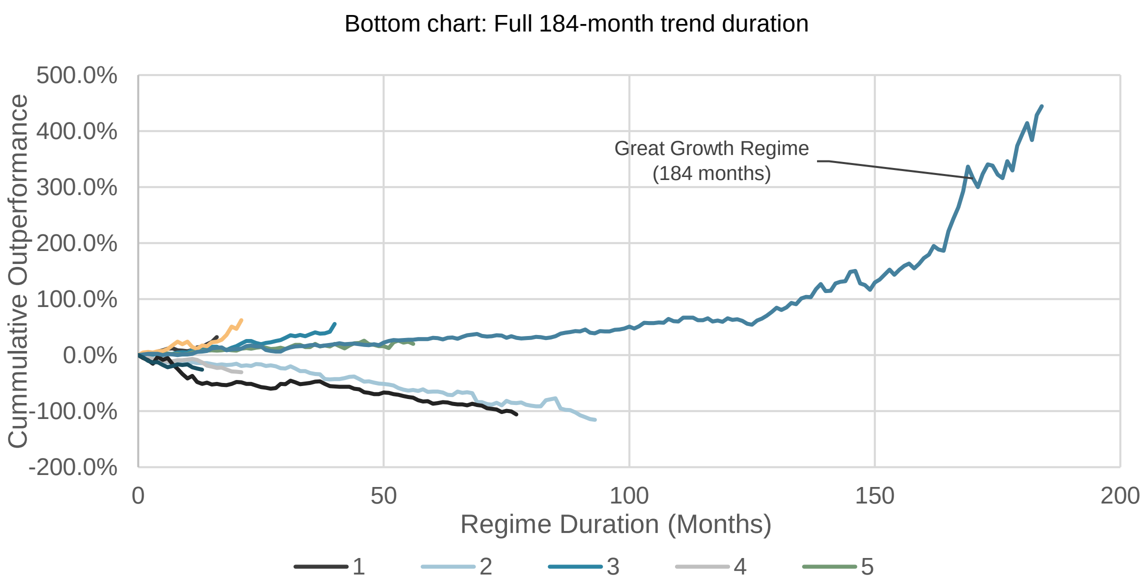
The motivating factor behind this question is that since 1979, Russell 1000 Growth and Value Style indices have produced eerily similar returns, differing by only 8.7% after 43 years. If over the long run both style strategies have delivered investors to the approximately the same place, then how large precisely are the fluctuations between growth and value—and more importantly, are the results material to investors? By examining performance data spanning nine style regimes, we find style returns are highly significant with the magnitude of style trends, approximately 40% larger, on average, than the expected market rate of return. This analysis explores the nuances of style return behavior, how this performance can be quantified, and most importantly, the practical implications for investors.

How to measure an undercurrent

There are a number of different methodologies for measuring the intensity of style trends, each with advantages and disadvantages. The most intuitive of these approaches is to simply calculate the outperformance of either growth or value in each style regime. This framework carries the benefit of demonstrating, dollar for dollar, how much additional gain an investor would capture by allocating to dominant style. Using two different time scales, Figure 2 illustrates the outperformance of growth or value in each of the 9 style regimes (positive trendlines indicate growth regimes, and negative value regimes), and yet also underscores the deficiencies of this approach. The top chart shows style relative performance truncated to a total regime length of 96 months (8 years), and clean patterns emerge. During value regimes, the style tracks fairly consistently with average outperformance at a rate of 1.52% per month, and while subject to some flares of exuberance, growth trends progress at an average of 1.83% per month.

Figure 2: Style trend outperformance





Relative performance of the outperforming style during each of 9 market regimes. The top chart style trend depicts style trends truncated to a total of 96 months in duration, and the bottom chart extends observation history from 96 months to 184 months to illustrate the unique dynamics of the Great Growth Regime (GGR). Positive trend lines indicate growth cycles, negative signify value trends. The takeaways are three-fold, first that the Great Growth Regime is an extreme outlier, second that accumulated trend outperformance is a poor measure of style regime intensity due to the GGR, and third, value cycles trend consistently while growth cycles spike as they culminate.

Source: FTSE Russell, data as of December 31, 2022.

The lower chart in Figure 2, however, demonstrates the fallacy of using raw outperformance to evaluate style trends. Extending the time horizon include the full length of the Great Growth Regime of the preceding decade, which spans a full 184 months, entirely distorts the observed patterns of the top chart; the Great Growth Regime is quite simply a chart-breaker. It is not that the Great Growth Regime is a particularly intense rotation to growth, but rather that its extreme duration dwarfs the style returns of other regimes. A potent combination of rising asset prices and a compounding of outperformance on outperformance leads to a 444-percentage point premium to growth returns during this period. Indeed, this figure trounces the next most potent regime by a factor of 3.8. If there were any question as to the outlier status of the Great Growth Regime, Figure 2 dispels any illusions as to how anomalous the regime was relative to the other 8 style cycles of the last four decades. Quite evidently, a more robust methodology is necessary for gauging style regime intensity.

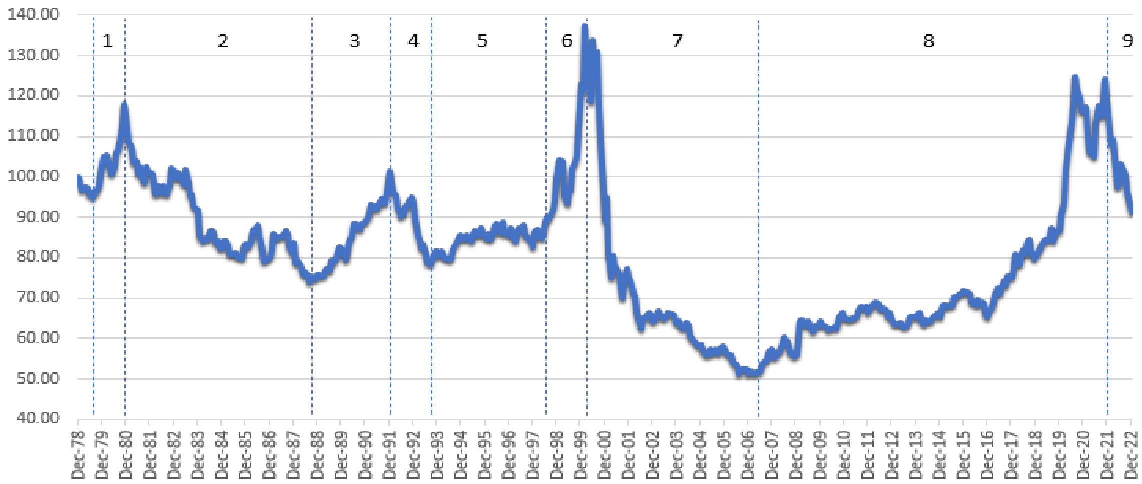
Using the ratio of total returns of the Russell 1000 Growth and Value indices, an extension of the framework introduced in the first analysis, helps standardize style drifts and avoid runaway compounding. Figure 3 illustrates the results of this ratio approach benchmarked to 100 in 1979, with upwards trendlines indicating rotation into growth and downward movement reversion to value. Whereas previously this method was used to periodize the history of style cycles, here we can measure the absolute shifts in growth and value positioning, and more significantly, the rates at which these shifts occur.

Markets in motion — but at what speed?

On average, style regimes witnessed a 40.9 percentage point shift between growth and value total returns, but there is a wide dispersion as to how intense these rotations can be. The most outsized of these movements was the collapse of growth in the early 2000s, which achieved a more than twice the average shift to value at 86.2 percentage points. By contrast, the most modest of these cycles was the mid-90s growth trend, during which total returns changed by only 6.4 percentage points—barely one-seventh the average value. Table 1 provides a granular breakdown of these 9 style regimes, the key data being the absolute change in percentage points and the velocity of these market currents in percentage points per month.

Important to note is that our present lunge towards value, in a span of only 13 months, is already at 80% the historical average for regime style deviation—it is a bit of an over-achiever. For further context, the current regime has retraced 45% of the preceding Great Growth Regime's style shift, and 38% of the Dot.com bubble's total displacement. Whether these figures indicate ample progress has been made in the current rotation, or contrastingly that significant runway remains for value outperformance, amounts to an open discussion.

Figure 3: Ratio of growth to value total returns: 1979-2022



Depiction of Russell 1000 Growth Index total returns divided by Russell 1000 Value Index total returns, parity set to 100 with an inception date of December 31st, 1978. Upward trends indicate strong growth performance, downward trends reveal strength in value.

Source: FTSE Russell, December 2022.

Much as with total change, great variation exists in the rates of return experienced during these style regimes. At the overall level, style trends undergo market rotation at rates of 1.15 percentage points per month, but the most vigorous transition is the current reversion to value at a rate of -2.52 percentage points per month (in keeping with Figure 3, movements towards value are expressed as a negative). To be clear, this constitutes a striking transfer of shareholder wealth from growth to value companies, surpassing even the rate of the final ramp up in the late 90s dot.com bubble. Markets have never realigned more rapidly along lines of style than the rotation presently underway at the regime level.

Table 1: Quantitative breakdown of growth and value style regimes

	Start	Duration	PP Change	PP/Month	Average Monthly Style Return (%)	Cumulative Outperformance (%)
1	7/31/1979	16	23.13	1.445	1.40	32.19
2	11/30/1980	93	-44.01	-0.473	-0.51	-115.44
3	8/31/1988	40	27.25	0.681	0.80	55.70
4	12/31/1991	21	-22.96	-1.094	-1.23	-30.49
5	9/30/1993	56	6.41	0.115	0.14	20.17
6	5/30/1998	21	52.68	2.509	2.33	62.40
7	2/29/2000	77	-86.24	-1.120	-1.28	-105.86
8	7/31/2006	184	72.91	0.396	0.49	444.40
9	11/30/2021	13	-32.75	-2.519	-2.33	-25.93

Four different measures of trend size and intensity are depicted. PP Change denotes the percentage point change in the ratio of Russell 1000 Growth and Value Index total returns during each regime. Column PP/Month is the rate of change in the previous value and is the average slope for each regime in Figure 3. Data as of 12/31/22, end date of current regime remains to be determined. Average Monthly Style Return is the monthly compounded return premium enjoyed by the outperforming style. Cumulative Outperformance tabulates the trend totals from Figure 2.

Source: FTSE Russell, December 2022.

How can we contextualize this rate of transformation? If we take long-term expected equity returns to be 10% annually, this figure means that the present undercurrent to value is outpacing expected market returns by a factor of 3. As an alternative perspective, an investor would require expected annualized stock returns of 30% for the general market to exert the same contribution on overall returns as the current style gyrations.[3] While there are examples of short, intra-regime bursts that were more energetic, such as the growth collapse in early 2000s (-4.68 pp/m) and the collapse in value in early 2020 (5.22 pp/m), the current movement to value is nearly without precedent in 43 years of style market history.

On the other side of the spectrum, the most modest rate of transition was the interregnum growth regime of the mid-90s, beset between the post '91 value reversion and the dot.com bubble. At only 0.12 percentage points per month (1.5 pp annually), this period captures the only sustained occurrence of growth and value strategies expanding in balanced, nearly equal fashion from a statistical standpoint.[4] Indeed this "pause" in style return disparities underscores just how dynamic style trends are throughout the observed history, as the average trend rate is an order of magnitude larger, and the present movement higher by 21-fold.

[3] This contribution comparison merely refers to expected returns, and not risk contribution, which is a more involved and technical discussion beyond the scope of this analysis.

[4] Statistically equal in this case refers to trend volatility far outstripping the average trend rate of return; the observed pattern does not demonstrate statistical significance.

Putting a premium on style

A further observation is the disparity between the growth and value regimes in terms of their trend velocities. As broken down in Table 1, value regimes see average outperformance of 1.30 percentage points per month compared to the 1.03 percentage points of their growth counterparts—hence value cycles have been 26% more vigorous. Figure 4 illustrates this point by depicting the premium (or discount in case of negative values) of style regime returns relative to the expected average monthly equity returns of 0.797% (a value of 0% indicates parity with this expected rate of return). Given that value cycles in red dominate the right-hand side of Figure 4, this observation somewhat jars with the popular image of growth as the more dynamic of the two styles. When considered in terms overall regime behavior, however, value cycles are clearly more aggressive—why is this the case?

Depicted in Figure 3, growth has a tendency to spike in exuberance as a trend culminates, as seen in regimes 1, 3, the entirety of regime 6, and regime 8. Our perceptions are biased towards these short bouts of excess in growth, and we consequently underweight the slow grind that constitutes the bulk of growth cycles. Equally, we underemphasize the striking gains to value after growth overextends itself, attributing this dynamism to growth when in fact it is a feature of value regimes. In consequence, investors suffer from availability bias with respect to growth cycles, recalling the most dramatic facets simply because they are so memorable—even though they are unrepresentative of growth cycles holistically.

The Great Growth Regime of the previous decade underscores this misperception of growth cycles quite persuasively. Despite the immense outperformance over its 15.5 year span, it was the most anemic all style cycles—excepting only the essentially flat mid-90s growth regime. In fact, the regime accrued gains to growth at only 0.39 percentage points per month, a rate nearly two thirds below the historic average. Examining Figure 2 corroborates this argument, where the Great Growth Regime performs roughly in line with the “flat” mid-90s regime in terms of the rate of growth outperformance.

Figure 4: Style trend returns as relative percentage of expected equity returns

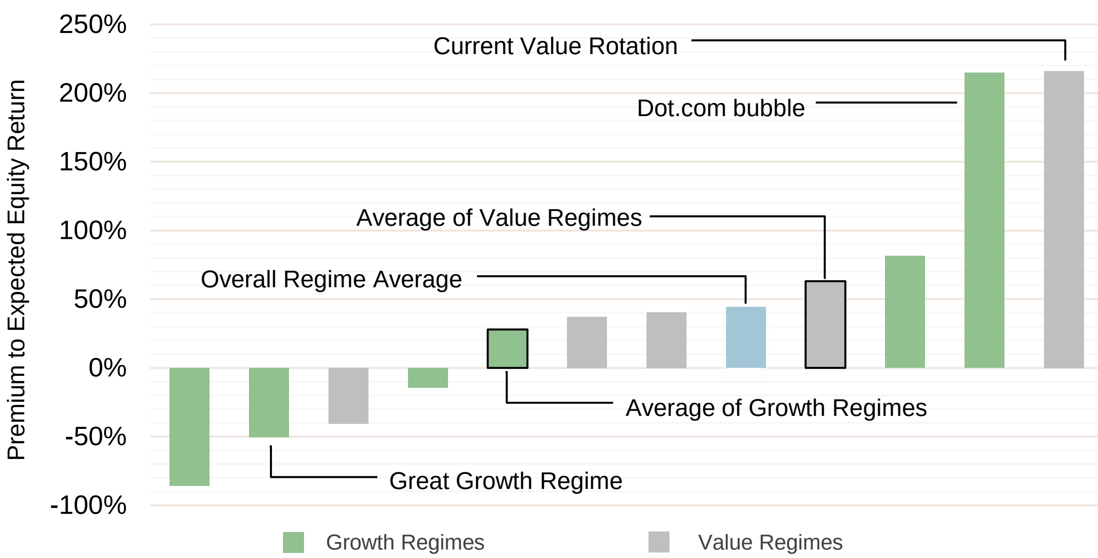


Figure 4: Depicted are the monthly style regime returns compared to expected monthly equity returns on a basis of a premium or discount. Hence, the average trend return of 1.15 percentage points per month is expressed as 44.3% premium to expected equity returns of 0.797%, and the current value rotation of 2.52 pp/month is shown as a 216% premium. A value of 0% indicates parity with equity returns, green column growth cycles and red columns value cycles.

Source: FTSE Russell, December 2022.

It is only the compounding of style returns, amidst a broadly rising market for such an extraordinary period of time, coupled with the unprecedented collapse of value early in the pandemic, that fueled such stratospheric growth outperformance. The reality is markets have transitioned from the near slowest period of style drift to the most rapid in history, which amplifies perceptions of the current rotation's strength. Indeed, after spending a decade and a half in the style doldrums, investors may need to recalibrate expectations of the tidal forces at play under the market surface.

Tweed jackets aside… style returns hardly academic

In practical terms, however, what do these numbers imply for investors? Figure 5 gives concretion the import of style trends, showing the consequences of correctly and incorrectly allocating to these market undercurrents. Depicted on a logarithmic scale, we can see the Russell 1000 Index appreciated 128-fold over the referenced 43-year span. Successfully riding the wave of the outperforming style across all nine regimes, however, would enhance these capital gains a further seven times for a staggering 897 multiple increase; we will denote this the trend clairvoyance strategy.

Figure 5 Allocating to style on a trend surfing basis

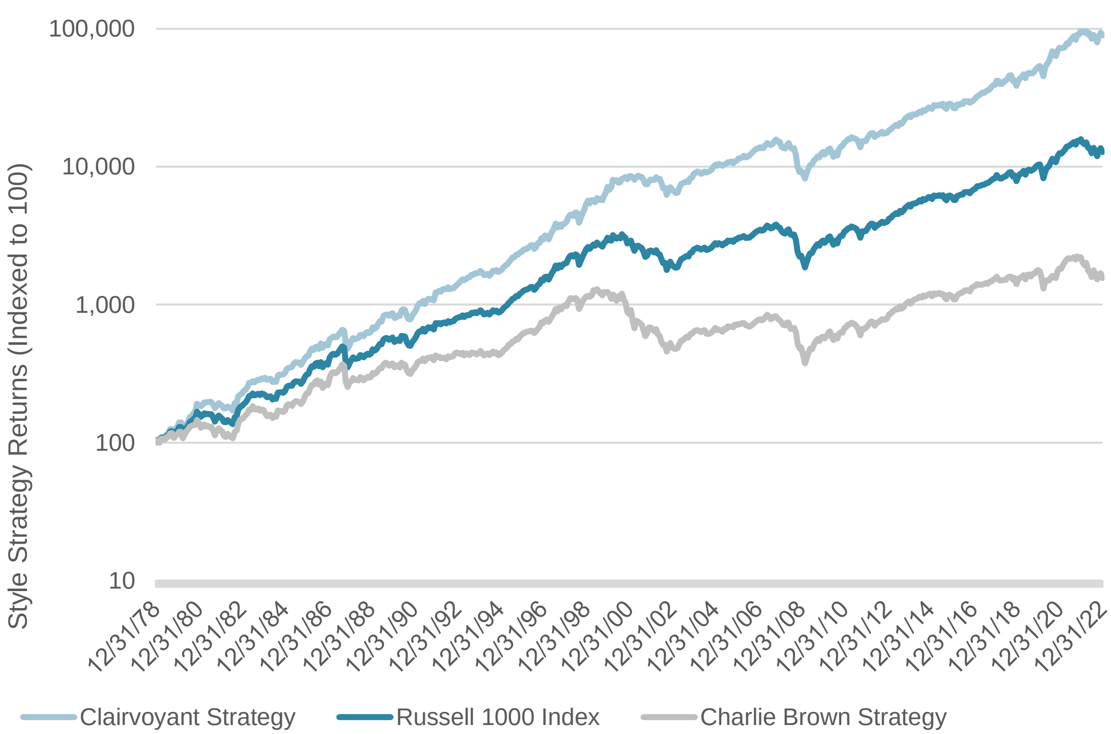


Figure 5: Timeseries analysis of successful and unsuccessful allocation to growth and value styles. Clairvoyant strategy refers to the consistent selection of the outperforming style trend, and the Charlie Brown timeseries denotes allocation to the underperforming style regime.

Source: FTSE Russell, December 2022.

Conversely, if an investor were to precisely target each unfavored style regime, a so-called Charlie Brown approach to trend capture, equity appreciation would be curtailed to only 12% of benchmark gains. Clearly style regimes impart a material effect on investor outcomes, as both perfect and perfectly flawed trend selection influence returns by nearly an order of magnitude in their respective directions. While not complex, this example is perhaps the best demonstration of the raw power of style returns, both in their monthly returns and in their broader regimes. It also addresses the potential merit of aiming to systematically capture these return patterns, as the potential upside can be tremendous.

Conclusion and market implications

By analyzing nine distinct periods of style returns, spanning 43 years of Russell 1000 Growth and Value Index history, we can readily conclude style trends carry substantial impact. Even though both styles have achieved roughly comparable returns over the long run (currently differing by 23 basis points annualized), the vicissitudes of growth and value are prime drivers of return. Indeed, the average style regime moves at a pace 44% greater than expected market returns, with respective values of 1.15 and 0.797 percentage points per month. Moreover, value regimes on average move more rapidly than their growth counterparts, largely a consequence of growth's greater susceptibility to style collapse.

Far from a trickle, style trends are a veritable gulfstream to the market's overall motion. The focal point of this analysis is to see that second to overall equity exposure, style regimes will likely constitute an investor's largest risk factor. The current rotation bears testament to this phenomenon, with value losing only 1.7% compared to growth's 27.6% decline since the regime transition in November 2021. These tidal forces bear great consequence—and deciphering their rhythm is a paramount concern for the successful investor. To this end, the first analysis in this series examined the frequency of style trends, this analysis assessed the amplitude of their wave function, and the third will explore what motivates style regime transition.

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