

VALUE STOCKS IN LIMELIGHT

THE BENEFITS OF A MULTIFACTOR APPROACH TO VALUE HAVE BEEN APPARENT IN VALUE'S RESURGENCE

According to our [Capital Markets Assumptions: 2022 Edition](#), expected returns from European equities over next 5 years are likely to fall well short of performance that they have delivered in the prior 5-year period. With valuations elevated for growth stocks towards end of 2021, what can an investor do to potentially improve investment outcomes?

2021 witnessed several important outcomes regarding performance of European stocks:

- First was **value's resurgence to start the year** as investors began to position portfolios for an economic re-opening post the vaccine rollout. Value cooled off in the second and third quarter, but had a **solid fourth quarter**
- Second was **investors' returned focus on fundamentals**. Since the end of Q1 2021, high quality European companies that are managed more efficiently, are more profitable, and generate higher levels of cash flow significantly outperformed their low-quality counterparts and the markets for the rest of 2021.

Although it can be helpful to think of factors independently, they are often times at their most potent when combined. Indeed, that is how we build all of our factor-based portfolios at Northern Trust. We see the benefits to multi-factor investing over the long-run, but it was especially important for certain factor combinations in 2021, notably value and quality. Value rallied sharply in the first quarter of 2021, but it was mostly low-quality companies whose stock prices had been depressed due to the economic fallout from COVID. Over the final three quarters, value was relatively flat. However, over this same period, high quality stocks *within* the high value segment significantly outperformed both the market and their low quality, low value counterparts. **In a value portfolio, quality can help identify so called "value traps"** that look favorable on valuation, but less so once fundamentals are taken into account. Integrating a fundamental assessment of potential to generate profits and cashflows within a value portfolio has been key to investment outcomes from European value strategies in 2021.

To start 2022, perhaps the biggest factor story is value's continued resurgence, with European value stocks having the best monthly performance relative to European growth stocks since 1998, using performance difference between MSCI Europe Value and Growth as proxies.¹

¹Sources: Northern Trust, MSCI Bloomberg, Monthly observations from 12/31/1998-02/28/2022.

VALUE STOCKS IN LIMELIGHT

Investors continue to re-price growth stocks, especially those whose earnings outlooks disappointed investor's lofty expectations.

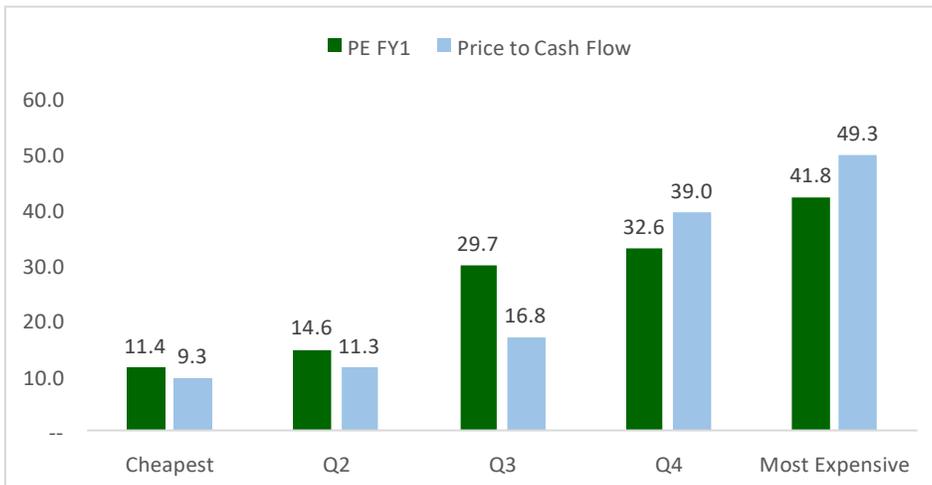
On the contrary, **earnings growth expectations for value stocks have been revised upwards through 2021** (Exhibit 1), resulting in them becoming progressively cheaper relative to growth stocks. This has led to an interesting opportunity for value stocks in Europe, with both standalone valuations and valuation dispersion relative to growth stocks being attractive. (Exhibit 2)

Exhibit 1 : Expected earnings growth is in favour of value stocks



Source: Northern Trust, MSCI, FactSet. As of 12/31/2021. Medium term earnings growth expectations for quintiles by number of securities within the MSCI Universe

Exhibit 2 : Value Stocks have attractive valuations and significant valuation dispersion relative to the growth stocks



Source: Northern Trust, MSCI, FactSet. As of 12/31/2021. Estimated FY1 Price to Earnings and Price to Cashflow within MSCI Europe universe. Portfolios formed as quintile by number of securities within MSCI Europe universe.

Further, while there is little to no long-term relationship between inflation/ interest rates and equity factors, our research² has shown that a linkage between **value and interest rates has emerged in last decade**. Hence, a change in accommodative stance for Central bank policies or rise in interest rates over medium term may also be a supporting variable for the value factor.

Conclusions

In 2021, investors have been rewarded for taking exposure to European value stocks and in particular to high quality value stocks in Europe. Since the start of 2022, given low expectations for asset class returns and macro and geopolitical uncertainty, **markets are placing a great emphasis on fundamentals and valuations**. Investors hence can look at value as time-tested sources of excess return in the market. But, as always, **the devil is in the details: we encourage investors to consider multi-factor approach to value for better diversification and pay attention to how risks are controlled in portfolio construction**.

² What's driving value? – Rob Lehnerr,CFA ; Di Wang ,PH.D. - Northern Trust as on 12/31/2021

Important Information

For Use with Institutional Investors and Financial Professionals Only. Not For Retail Use. The information contained herein is intended for use with current or prospective clients of Northern Trust Investments, Inc. The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. Northern Trust and its affiliates may have positions in and may effect transactions in the markets, contracts and related investments different than described in this information. This information is obtained from sources believed to be reliable, and its accuracy and completeness are not guaranteed. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor. Opinions and forecasts discussed are those of the author, do not necessarily reflect the views of Northern Trust and are subject to change without notice.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Indices and trademarks are the property of their respective owners. Information is subject to change based on market or other conditions.

All securities investing and trading activities risk the loss of capital. Each portfolio is subject to substantial risks including market risks, strategy risks, adviser risk and risks with respect to investment in other structures. There can be no assurance that any portfolio investment objectives will be achieved, or that any investment will achieve profits or avoid incurring substantial losses. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Any discussion of risk management is intended to describe Northern Trust's efforts to monitor and manage risk but does not imply low risk.

Investing involves risk- no investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

Simulated and actual past performance is not a reliable indicator of future results and should not be the sole factor of consideration when selecting an investment product or strategy.

Past performance is not guarantee of future results. Performance returns and the principal value of an investment will fluctuate. Performance returns contained herein are subject to revision by Northern Trust. Comparative indices shown are provided as an indication of the performance of a particular segment of the capital markets and/or alternative strategies in general. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Net performance returns are reduced by investment management fees and other expenses relating to the management of the account. Gross performance returns contained herein include reinvestment of dividends and other earnings, transaction costs, and all fees and expenses other than investment management fees, unless indicated otherwise. For additional information on fees, please refer to Part 2a of the Form ADV or consult a Northern Trust representative.

Forward-looking statements and assumptions are Northern Trust's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc. Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K, NT Global Advisors, Inc., 50 South Capital Advisors, LLC, Belvedere Advisors LLC and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

© 2022 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A.