Why Value Stocks Look Attractive to Us Now

> *"All intelligent investing is value investing - acquiring more than you are paying for."*
>
> *-Charlie Munger, Warren Buffet's Partner at Berkshire Hathaway*

In our May 2024 newsletter, we focused on the importance of dividends in our equity investment strategies. (If you missed this or want to view it again click this link.)

In today's dynamic financial landscape, understanding where to position your investments is crucial for optimizing your portfolio's performance. Over the next three editions of our newsletter, we'll be delving into why we believe value stocks hold significant promise for attractive risk-adjusted returns and enhanced diversification.

Why Value Stocks?
This series will highlight three key factors driving our optimistic outlook on value stocks:

- **Current Valuations**: In the first installment, we'll explore the current attractiveness of value stocks compared to growth stocks. With value stocks currently priced more appealingly, they offer a potential for price appreciation, attractive dividend return, and the potential for increasing dividend yields.
- **Impact of Interest Rates**: The second article will examine how the current interest rate environment influences the performance of value and growth stocks. Historically, value stocks have thrived when interest rates are normalized, a scenario we believe is unfolding now.
- **Reversion to the Mean**: Our final piece will address the prolonged outperformance of growth stocks over the past 15 years, a trend that deviates from historical norms. We'll discuss how reversion to the mean could benefit value stocks and the long-term themes that make them a compelling choice for your investment strategy.

Why Should You Care?
By focusing on value stocks, we aim to provide you with investments that offer attractive risk-adjusted returns and enhance the diversification of your portfolio. In an environment where growth stocks have dominated, the shift towards value stocks could unlock new opportunities for wealth preservation and growth.

Our goal is to ensure that your investment plan is robust and adaptable to changing market conditions. We believe that by integrating more value stocks into your portfolio, we can achieve a more balanced and resilient investment strategy.

In this month's "Bespoke Briefing" we'll delve deeper into the current valuation landscape of value versus growth stocks. Our aim is to provide you with clear, actionable insights that directly impact your financial success.

Valuation Comparison The P/E ratio of the Russell 1000 Value Index is significantly lower than that of the Russell 1000 Growth Index. Historically, such valuation gaps have preceded periods of outperformance for value stocks as markets correct overvaluation in growth stocks and revalue underappreciated value stocks. This trend is further supported by price-to-sales ratios, which also highlight the relative undervaluation of value stocks.

Valuation Perspective | Value vs Growth

Data Ending December 2023

Large Cap Value PE Ratios

5-Year Periods	Low	Average	High
2000 - 2004	15.44	17.21	20.51
2005 - 2009	8.22	13.83	16.84
2010 - 2014	10.93	14.36	16.72
2015 - 2019	13.44	17.16	20.20
2020 - Present	13.21	17.31	23.47
Total Average		**15.92**	
Current PE		**16.63**	
Current PE relative to long term average			**104%**

Large Cap Growth PE Ratios

5-Year Periods	Low	Average	High
2000 - 2004	21.10	28.95	44.96
2005 - 2009	10.70	19.29	23.43
2010 - 2014	14.82	18.65	22.10
2015 - 2019	19.94	24.02	28.65
2020 - Present	23.70	30.77	37.09
Total Average		**24.07**	
Current PE		**33.00**	
Current PE relative to long term average			**137%**

Large Cap Value Total Returns

5-Year Periods	Annualized Total
2000 - 2004	5.27%
2005 - 2009	-0.25%
2010 - 2014	15.42%
2015 - 2019	8.29%
2020 - Present	7.31%
2000 - Present	**7.08%**

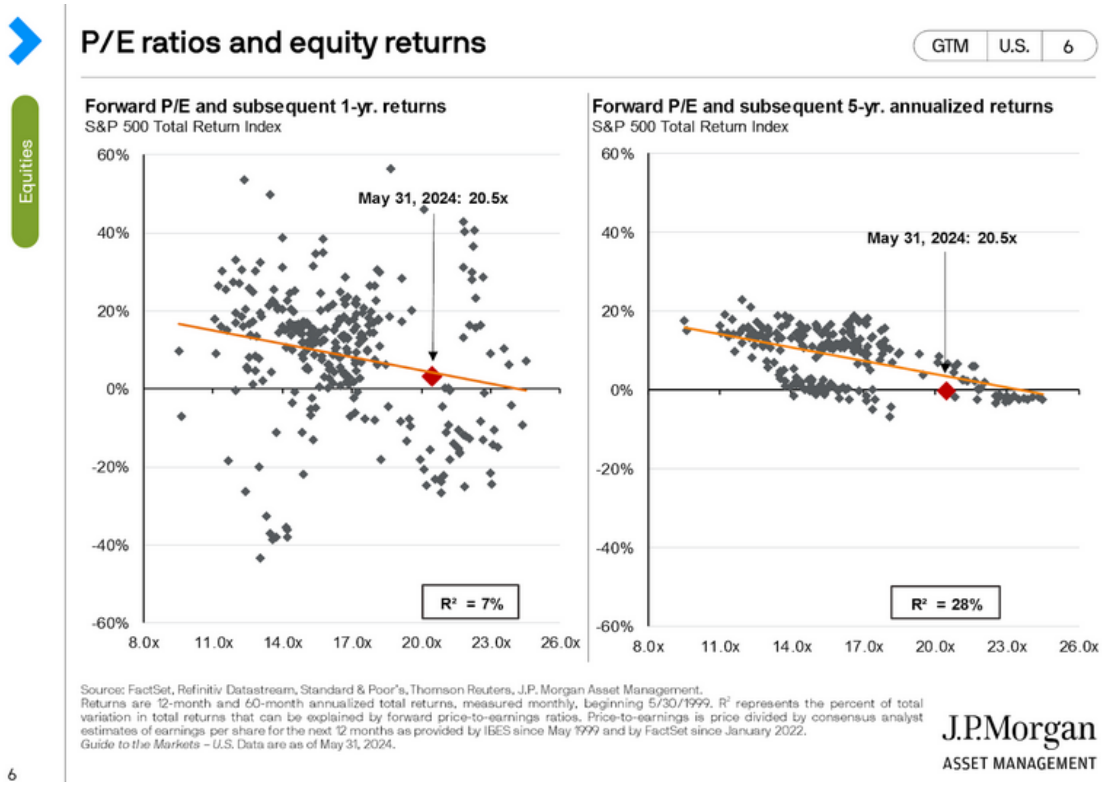
Large Cap Growth Total Returns

5-Year Periods	Annualized Total
2000 - 2004	-9.29%
2005 - 2009	1.63%
2010 - 2014	15.81%
2015 - 2019	14.63%
2020 - Present	15.61%
2000 - Present	**6.85%**

Data Sources: Morgan Dempsey Capital, Morningstar.

Valuations can confuse investors at times. This is because there is often a lag between stocks reaching a point of being overvalued or undervalued and the market moving to correct this inefficiency. Valuations are not necessarily predictive of an equity's move in the near term, but they are reliable indicators of a stock's likely direction over the medium and long run.

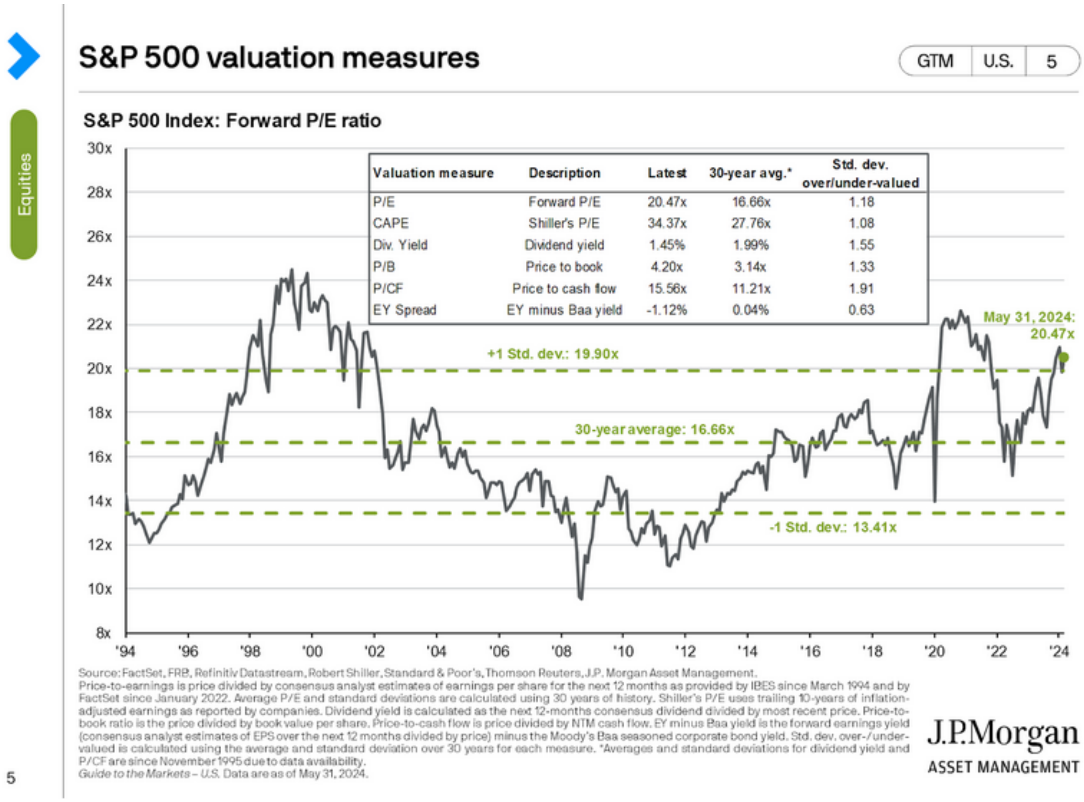
J.P. Morgan's Asset Management team has tracked the relationship between Price-to-Earnings Ratios and Equity Market Returns for many years and includes this analysis in their "Quarterly Guide to The Markets." We have included the most recent chart from their May 31, 2024, publication, which is presented below:



At first the chart can appear a bit confusing and frankly that is the point. The Scatterplots show the "Current Price Earnings Ratio (P/E) of the S&P 500" along the horizontal axis. The vertical axis depicts the "Monthly Annualized Total Returns, Measured Monthly". The scatterplot on the left is the 12-month chart. It is rather chaotic and appears to be a randomized series of events. There is no discernable correlation between the P/E levels and the S&P 500's subsequent 12- month total return. The chart on the right however, which displays monthly annualized returns, measured over a 5-year period is highly informative. As you move to the right, along the horizontal axis, you are observing higher and higher P/E ratios for the S&P 500. The line at the mid-point of the vertical axis indicates a 0% annualized 5-year return for the S&P 500.

Observing the right side of the chart, one sees that when the S&P 500 traded much above a P/E of 20, the total annualized returns over the preceding 5 years were concentrated in the range of 0% or less. Conversely, when the index was trading between 11 and 17, the concentration of outcomes was generally positive, with many periods producing annualized total returns in the 10%+ range. Obviously, these historical observations are no guarantee of future results. However, it should be noted, that these data sets cover a period of 25 years, from May 1999 to May 2024. In our experience data that are this robust in terms of observations and discernable trends should influence investors' thinking and actions.

So where are we today? Again, relying on the work of the J.P. Morgan Asset Management Team and borrowing from their May 2024 "Guide to the Markets", let's look at a chart that tracks the "Forward P/E Ratio" of the S&P 500 over the past 30 years. The "30-Year Average Forward P/E" is 16.66x. One standard deviation above the average is 19.90x. This indicates that stocks are at least fully valued and perhaps even overvalued. Recall the preceding chart, "P/E Ratios and Equity Returns." We saw there that over 20x, the increased probability of "5-Year Average Total Returns" coming in at 0% or 0% or less. Today the S&P 500 trades at a forward P/E of 20.47. Many of today's hottest tech stocks, often referred to as the "Magnificent Seven", traded at a forward P/E of 35 according to FactSet as of January 2, 2024. Given that these stocks have risen approximately over 20% thus far in 2024, the forward P/E has only risen since then.



The disparity in valuations between growth stocks and value stocks, as measured by their current P/E and forward P/E, is one of the primary factors influencing our strong focus at the moment on value stocks. Refer again to the first chart here entitled "Valuation Perspective/Value vs Growth" above. As of the beginning of 2024, the Russell 1000 value index traded at a P/E ratio of 16.63, while the Russell 1000 Growth Index traded at a P/E of 33.

Closing Summary and Recap

In this edition of our newsletter, we explored the compelling case for incorporating value stocks into your investment strategy. Here's a quick recap of the major points discussed:

- **Current Valuations**: We highlighted the current attractive pricing of value stocks relative to growth stocks. Value stocks are currently undervalued, presenting opportunities for price appreciation, attractive dividend returns, and potential for increasing dividend yields.
- **Impact of Interest Rates:** We examined how the current interest rate environment benefits value stocks. Historically, value stocks have outperformed in periods of normalized interest rates, a scenario that appears to be unfolding now.
- **Reversion to the Mean**: We discussed the prolonged outperformance of growth stocks over the past 15 years, which deviates from historical norms. As market dynamics shift, we believe value stocks are well-positioned to benefit from a reversion to the mean.

Why This Matters to You

Our focus on value stocks is aimed at providing you with investments that offer attractive risk-adjusted returns and enhance your portfolio's diversification. In an environment dominated by growth stocks, shifting towards value stocks can unlock new opportunities for wealth preservation and growth. This strategic approach helps ensure your investment plan remains robust and adaptable to changing market conditions.

Enhancing Your Investment Plan

By integrating more value stocks into your portfolio, we aim to achieve a more balanced and resilient investment strategy. This alignment not only supports your long-term financial goals but also helps you live your best life and take care of the people and organizations you care about—both now and in the future.

Relevant Insights

We provided actionable insights through the valuation comparison between the Russell 1000 Value Index and the Russell 1000 Growth Index. Historical data, like the relationship between Price-to-Earnings Ratios and Equity Market Returns from J.P. Morgan's "Quarterly Guide to The Markets," reinforces the reliability of these indicators over the medium and long run.

Where Are We Today?

Using the most recent data from J.P. Morgan's "Guide to the Markets," we observed that the S&P 500 trades at a forward P/E of 20.47, with some of the hottest tech stocks trading at even higher multiples. This disparity underscores our emphasis on value stocks, which offer a more reasonable valuation and potential for robust returns.

By focusing on these key factors and leveraging historical trends, we believe that value stocks present a significant opportunity for your investment strategy, helping you effectively execute your investment plan and achieve your long-term objectives.

We never want to leave you without expressing our heartfelt gratitude for your ongoing loyalty and confidence in our team. Every day, we strive to earn this trust and are profoundly grateful for the opportunity to serve you and your family. It is our privilege to partner with you to ensure you live your best lives, support the people and causes most important to you, and pursue your highest aspirations.

These newsletters are designed to serve you and your family by sharing the insights guiding our team in executing your investment plan and portfolio objectives. Our goal is to deliver maximum value to you. If you have any topics, you'd like us to address, suggestions for future newsletters, or comments on this edition or previous ones, please reach out to us directly using the attached email link to the Reich Fitzpatrick Private Wealth Group of Wells Fargo Advisors.

Thank you for your time and interest in our newsletter. Please feel free to share it with family and friends who might find it valuable. We are here to be a resource for you, your family, and your friends, ensuring financial security and freedom so you can pursue your highest aspirations.

S&P 500 Index: The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Wells Fargo Advisors did not assist in the preparation of this report, and its accuracy and completeness are not guaranteed. The report herein is not a complete analysis of every material fact in respect to any company, industry or security. The opinions expressed here reflect the judgment of the author as of the date of the report and are subject to change without notice. Any market prices are only indications of market values and are subject to change. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Additional information is available upon request.

Russell 1000® Growth Index: The Russell 1000® Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000® Value Index: The Russell 1000® Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

Past performance does not guarantee future results.

Index returns are not fund returns. An index is unmanaged and not available for direct investment.

Asset allocation and diversification are investment methods used to help manage risk. They do not guarantee investment returns or eliminate risk of loss including in a declining market.
Dividends are not guaranteed and are subject to change or elimination.

PM-12282025-6580668.1.2

Our mailing address is:
1753 Pinnacle Drive
Third Floor
McLean, VA 22102