In part 1 of this series, we examined the value premium's origins and proposed that evidence-based investors are well-advised to keep the faith on value investing, giving due consideration to how it meshes with their personal financial goals and risk tolerances.

Still, a decade is a long time to tolerate disappointing numbers while awaiting an expected reward. For many of us, our children are about the only other misbehaving "investment" we would put up with for that long.

However, we prefer to consider value stock performance over a decade or more, since the expected outperformance can go into hiding for years, and often has.

A 2015 CFA Institute post noted: "A 'disappearing' value premium, even over a 10-year stretch, is nothing new. In fact, since the late 1970s, 27% of all rolling 10-year periods have seen a negative value premium." Of course, this means
73%
of them delivered a positive premium.

These seem like favorable odds. However, when a source of expected return does resurface after a hiatus, it's often in the form of an exuberant leap nobody saw coming, except in hindsight. For example, in the same CFA Institute post noted that growth stocks had outperformed value by 2.1% annually for the decade ending October 2000. Then the tables turned and value bested growth by 35% over the next five months. This single surge helped value outperform growth by 2.4% for the 10 years ending May 2001.

In short, only those who can tolerate the doldrums tend to still be around to reap the unpredictably timed windfalls that can dramatically impact returns.

Going Global

What other evidence do we see of the value premium's viability? First, much of the press covering the value premium has focused on U.S. performance. Yet over the past decade or so, international value stocks have often performed more robustly than their U.S. counterparts.

In a 2018 ETF.com post, financial author Larry Swedroe commented: "If value is 'dead,' we should find confirming evidence in other [non-U.S.] markets." He then used data to show that the premium was at that time alive and well in international developed markets over 10 years. Depending on which metric he used, the value premium ranged from 1.9% (price to book ratio) to 4.1% (price to earnings ratio) from 2008 to 2017.

This suggests U.S. value stocks are more likely experiencing a random setback than defining a new global norm.

Popularity Contests and Future Expected Returns

More recently, Swedroe rebutted the suggestion that value investing has become a victim of its success. That is, as more investors have incorporated the value factor into their portfolios, has old-fashioned supply-and-demand eliminated the value premium?

We can't be certain, but we don't think so. It's more likely that investors who can't tolerate the recent underperformance are unwittingly setting the stage for the value factor's comeback.

Think about it: Whenever one investor wants to sell their shares, somebody else has to buy for the transaction to occur. As some investors waver and sell value stocks at reduced prices, bargain-hunters swoop in and position themselves for future expected growth. Eventually the pendulum is likely to swing.

That's how efficient markets have worked for decades if not centuries. It's how they're expected to continue to work. In other words, lower current prices actually suggest higher future returns.

Supporting evidence comes from a stock pricing measurement known as the spread. It measures the difference between the price buyers want to pay for a stock (the bid) vs. the price sellers want to receive (the ask). Wider bid/ask spreads mean prices are far apart; narrower spreads mean they're closer together.

As Swedroe observed, if overcrowding has occurred, spreads should narrow dramatically as cash flowing into value stocks and out of growth stocks affects relative prices. Yet his analysis of spreads among various market factors found "no evidence that cash flows have caused the ex-ante value premium to narrow, either in small stocks or large stocks."

Or, as J.P. Morgan's chief U.S. equity strategist said in a June 2019 MarketWatch column: "Value is currently trading at the biggest discount ever, and offers the largest premium over the last 30 years ." The strategist was referring to future, not current expected premiums. In other words, for those who stick with the value factor, solid evidence remains that the best is yet to come.

So far, we've offered a number of evidence-based reasons we remain confident that the value premium is far more likely slumbering than dead. Unfortunately, nobody can predict when it will awaken, or whether it will do so gradually or in a rush. We can't guarantee we're correct.

For better or worse, this is the nature of market risks and their expected rewards. The market's inherent uncertainties challenge the most disciplined investors. Even the late Vanguard founder John Bogle once said about his own roughly 50/50 stock/bond mix: "I spend about half of my time wondering why I have so much in stocks, and about half wondering why I have so little."

If you have your doubts, that's understandable. But before you actually change your investment strategies or abandon value investing, consider this 1999 sentiment from *The Journal of Portfolio Management's* founding editor, Peter Bernstein. ***"Even the most brilliant of mathematical geniuses will never be able to tell us what the future holds. In the end, what matters is the quality of our decisions in the face of uncertainty."***

Those words are as relevant now as they ever were.

What makes for quality decisions? Global diversification is a huge part of it. By spreading your risks across multiple sources of expected returns, you can better manage the very real risks involved in pursuing them. In the face of uncertainty, patient resolve and objective evidence are also among your greatest guides. Last but not least, we're here to help as well. Questions? Comments? Time for a talk? Let us know!