Value investing requires patience and a long-term perspective. While they may experience deeper drawdowns, value stocks have recovered faster and outperformed over time. Maintaining discipline during market volatility is key to realizing value's historical edge.

Achieving long-term investment success requires patience, discipline, and a focus on fundamentals rather than short-term market fluctuations. While value stocks have outperformed over longer time horizons, value investing is often misunderstood as being riskier or underperforming during market downturns.

This essay is the second installment in our series, Why We Are Active Value Investors. In part one, we covered the superior historical returns of value investing and the drawbacks of "value-light" strategies. In this installment, we

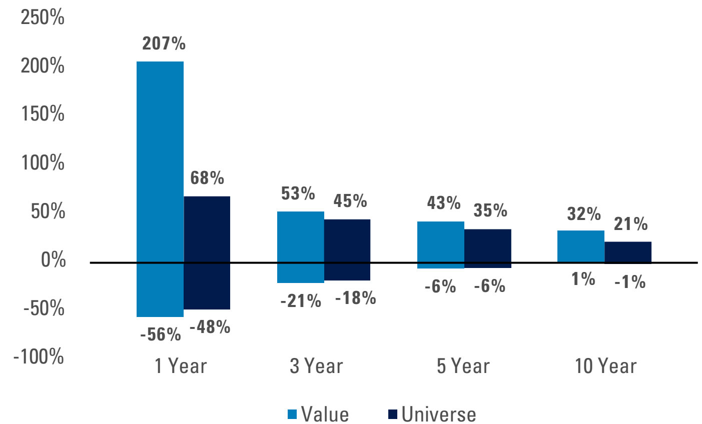
- discuss the importance of a long time horizon
- show that value recovers faster from drawdowns and has far superior five-year performance starting from the peak

By taking a comprehensive look at the data, we demonstrate that a long-term, disciplined commitment to value investing increases the likelihood of achieving expected results while weathering inevitable market volatility.

IMPORTANCE OF A LONG TIME HORIZON

Since all investment approaches suffer through drawdown periods, patience and a long time horizon are crucial to achieving a long-term performance objective. Longer time horizons have a narrower range of outcomes. Exhibit 1 shows the range of ACWI and ACWI Value performance outcomes over various periods. Although the range for one-year performance for ACWI is between +70% and –50%, the performance range narrows over longer rolling periods. At the 10-year point, the range is +21% on the high end and -1.2% on the low end. This indicates that over longer periods, investors are far more likely to achieve their expected results while also being far less likely to post negative absolute returns.

Exhibit 1: ACWI 5-year Rolling Returns Since 1975
Narrower Range of Outcomes Over Longer Time Horizons



Source: Sanford C. Bernstein & Co., Pzena analysis
Value = stocks within the cheapest quintile based on price/book of the MSCI ACWI universe (Equal Weighted). Universe = cap-weighted returns of MSCI ACWI universe. Total return US dollar data from January 1, 1975 – September 30, 2024.
Does not represent any specific Pzena product or service. Past performance is not indicative of future returns.

This underpins our unwavering commitment to the value discipline, regardless of the market environment. Numerous historical studies have shown that value portfolios outperform expensive portfolios, value-light portfolios, and the market (see our 3Q23 Newsletter Commentary). Having a long-term horizon narrows the range of outcomes, increasing the odds an investor will benefit from this historical outperformance.

VALUE'S RISKINESS MYTH

A popular misconception about value is that its superior long-term performance comes at the cost of additional risk (or volatility). We dispelled that myth in the first part of this series (see our 3Q23 Newsletter Commentary). But how does the range of outcomes for value compare to other strategies? As Exhibit 1 shows, the difference between the range of outcomes for value stocks narrows with a longer time horizon. Crucially, value stocks' wider range of outcomes is demonstrably dominated by upside tracking error (i.e., good tracking error).

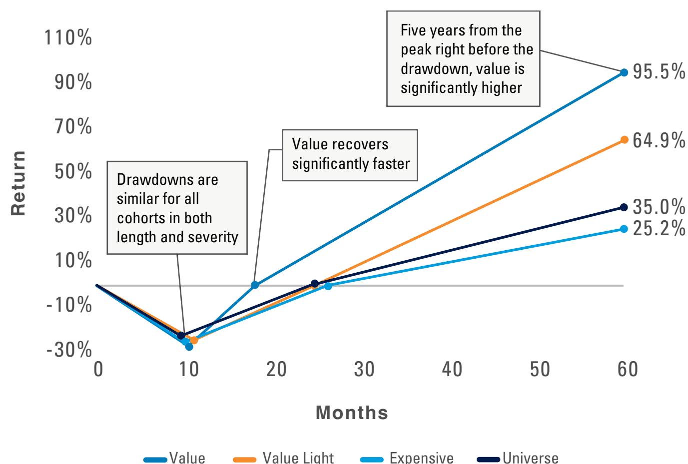
VALUE RECOVERS FASTER FROM DRAWDOWNS

Over the past 50 years or so, the market has seen 12 drawdowns >10%, or, on average, about one every four years. The performance of value

portfolios during these down markets is not fully understood.

On average, the market drawdown is about 23% and lasts around 10 months, with a recovery time of about five quarters. Interestingly, the drawdown for cheap stocks is about 450 basis points worse than the market, lasts about a month longer, but recovers seven months faster (Exhibit 2). A long-term time horizon also allows investors to weather these inevitable market drawdowns, as value, value-light, and expensive portfolios, as well as the market as a whole, recover sufficiently to generate positive five-year performance from the peak before the drawdown, with value significantly outperforming the other cohorts.

Exhibit 2: Value has Favorable Drawdown Characteristics
ACWI Average Drawdown Cycles Since 1975



Source: Sanford C. Bernstein & Co., Pzena analysis
Value *= stocks within the cheapest quintile based on price/book of the MSCI ACWI universe.*
Value Light *= 2nd cheapest quintile.*
Expensive *= most expensive quintile. The quintiles are measured on an equally weighted basis.*
Universe *= cap-weighted returns of MSCI ACWI universe.*
Drawdown periods are based on minimum 10% decline of the universe (12 declines since 1975).
Total return US dollar data from January 1, 1975 – September 30, 2024.
Does not represent any specific Pzena product or service. Past performance is not indicative of future returns.

This performance pattern is hardly surprising. Stocks trade down to the cheapest quintile because they have the highest degree of controversy, so it stands to reason that, as the market sells off, value equities perform somewhat worse. It follows that, as market fears subside, these stocks come back faster and outperform during the subsequent period.

As for the worst drawdown in the past 50 years, the Global Financial Crisis (GFC), the global markets experienced a 16-month drawdown of 55%, which took just over 4.5 years to recover. For value, the drawdown during the GFC was 500 basis points worse, lasted the same 16 months, but recovered in just over 1.5 years.

We believe these historic observations dispel the myth that value performs much worse during market drawdowns and highlight the importance of sticking with a value discipline during drawdowns, as the recovery is swift and often unexpected. Indeed, that is at least part of the reason for the value premium. During periods of maximum pain, investors' fears cause them to abandon value stocks at the moment they are cheapest and offer the best risk–return potential.

CONCLUSION

Achieving long-term investment success through value investing requires conviction, discipline, and patience. While value stocks may experience periods of underperformance and deeper drawdowns compared with the broader market, history has shown that maintaining a long time horizon increases the likelihood of realizing value's historical outperformance. The empirical evidence dispels the myth that value is riskier, demonstrating that value stocks exhibit a similar range of five-year outcomes and a better range of one-year outcomes while producing higher average returns in both periods. Investors who can stay committed to a value approach, even during challenging times, position themselves to capitalize on value's enduring edge. The cyclical nature of value's performance reinforces the importance of resisting the temptation to abandon a proven strategy during inevitable bouts of underperformance. Ultimately, a disciplined, long-term perspective grounded in the fundamentals of value investing gives investors the best chance of achieving their desired investment outcomes.

In a future installment of our series, we will delve into the robust fundamental risk analysis we perform to ensure the stocks we add to our portfolios can weather the inevitable deep economic and market downturns.

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