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Over the last 10 years, U.S. growth stocks have outperformed value stocks by an average of 7.8% per year, using the academic measure of value and growth as the bottom and top thirds of the Russell 1000 Index sorted by price-to-book ratios. That is one of the largest and longest differentials between value and growth on record. This is highly unusual because economists believe, and historical evidence confirms, that value stocks have higher expected returns than growth stocks due to their higher risk.



Source: Fama-French research returns outlined at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html#Research.

Small value stocks also underperformed large growth, but neither of these relative results was due to poor returns by small and value stocks. Rather, the differential was caused by large growth stocks experiencing remarkably high returns that were almost double their long-term historical average.

Ten years is a long time and as a result, some have suggested that the “value premium” has been erased by a change in business structure and the way investors now value companies. However, we have always maintained our view that small and value would recover from their performance deficit and that the value and size premiums still exist.

In a surprising turnaround, the returns of small and value in the last 12 months have gone a long way toward correcting things. In fact, small value stocks turned in their largest outperformance over large growth stocks since the end of World War II. Interestingly, the two periods have some economic similarities. In 1943, the country was experiencing optimism that the war was turning in our favor. Similarly, late last year many became optimistic that vaccine development would successfully pull our economy out of the Covid-19 crisis. Small value tends to do well during initial economic recovery, and did so during both of these periods.

To get a feel for how significantly things have changed, let's first look at small stocks versus large. Table One on the next page shows the performance of stocks as measured by deciles of size in the Center for Research in Securities Prices (CRSP) database as of March 31, 2020. The smallest companies (“CRSP 10”) lagged the largest (“CRSP 1”) in every category except the twenty-year and since-1926 periods.

Table Two shows the same chart one year later. Remarkably, all returns except the 10- and 15-year results are now positive. The decade of small-cap underperformance has been substantially corrected in just 12 months, but there is still some room to run to get back to long-run averages.

Turning now to value, using the standard academic definition of valuation, "book-to-market," we can examine how far out of favor small value stocks became before March 2020 and how much they have come back to the mean.

The chart at the bottom of the page shows the ratio of median book-to-market (BtM) for the Russell 2000 Value Index to median BtM for the S&P 500. The solid green line shows the median ratio for the entire history of the Russell 2000 Value, from January 1978 to March 2021. Ratios above this line signal that small-cap value stocks are cheaper than their historical average.

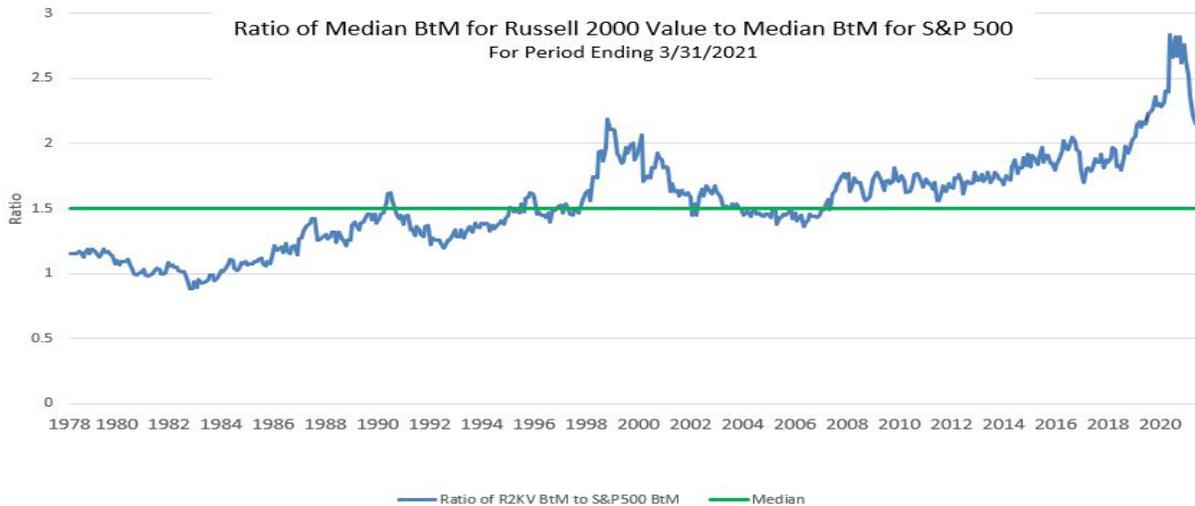
Holding book value constant and varying only the relative prices of small-value stocks, prices would have to rise 43% from their March 31, 2021 levels to return to the historical median ratio. While we do believe these factors will correct themselves and revert to their means, we do not believe anyone can know when this will happen. It took more than a decade to get here so it seems reasonable that it might take that long to correct.

Table One as of 3/31/20

| Annualized (%) | | CRSP | | | | | | | | Since |
|------------------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|-------------|-------------|-------|
| Decile | QTD | 6-mo | 1 yr | 3 yr | 5 yr | 10 yr | 15 yr | 20 yr | inception | |
| 1 (ultra-large) | -17.29 | -9.24 | -4.00 | 6.95 | 8.01 | 10.88 | 7.82 | 4.12 | 9.28 | |
| 2 | -24.17 | -18.81 | -14.66 | 0.87 | 3.65 | 9.91 | 7.85 | 6.66 | 10.27 | |
| 3 | -28.00 | -22.09 | -20.06 | -1.11 | 1.97 | 9.08 | 7.30 | 6.26 | 10.64 | |
| 4 | -30.37 | -25.17 | -23.79 | -2.61 | -0.08 | 7.73 | 6.84 | 6.14 | 10.46 | |
| 5 | -30.00 | -24.45 | -25.16 | -5.54 | -2.19 | 6.67 | 6.90 | 5.56 | 10.85 | |
| 6 | -31.26 | -24.24 | -26.14 | -5.11 | -1.18 | 6.93 | 5.94 | 5.66 | 10.82 | |
| 7 | -31.50 | -23.72 | -24.17 | -2.65 | 1.41 | 8.73 | 7.53 | 6.81 | 11.17 | |
| 8 | -37.23 | -28.58 | -32.45 | -8.74 | -3.45 | 5.53 | 5.71 | 6.01 | 10.81 | |
| 9 | -33.57 | -23.08 | -27.91 | -5.86 | -0.71 | 6.54 | 5.88 | 6.24 | 10.94 | |
| 10 (ultra-small) | -33.79 | -25.40 | -30.86 | -8.06 | -3.22 | 4.77 | 4.98 | 7.44 | 12.57 | |
| CRSP 10 minus 1 | -16.50 | -16.17 | -26.86 | -15.01 | -11.23 | -6.11 | -2.84 | 3.32 | 3.30 | |

Table Two as of 3/31/21

| Annualized (%) | | CRSP | | | | | | | | Since |
|------------------------|--------------|--------------|---------------|-------------|-------------|--------------|--------------|-------------|-------------|-------|
| Decile | QTD | 6-mo | 1 yr | 3 yr | 5 yr | 10 yr | 15 yr | 20 yr | inception | |
| 1 (ultra-large) | 4.52 | 17.13 | 56.72 | 18.34 | 17.69 | 14.56 | 10.40 | 8.26 | 9.69 | |
| 2 | 7.38 | 26.95 | 72.10 | 16.56 | 16.58 | 13.88 | 10.51 | 10.48 | 10.78 | |
| 3 | 7.59 | 32.11 | 84.56 | 15.50 | 16.80 | 12.93 | 10.39 | 10.74 | 11.24 | |
| 4 | 10.35 | 37.82 | 86.16 | 14.86 | 15.36 | 12.21 | 10.02 | 10.97 | 11.06 | |
| 5 | 10.51 | 44.73 | 98.24 | 15.33 | 15.18 | 11.15 | 10.26 | 10.92 | 11.53 | |
| 6 | 14.04 | 56.24 | 118.00 | 17.88 | 18.18 | 12.96 | 10.30 | 11.02 | 11.61 | |
| 7 | 17.89 | 57.58 | 121.47 | 21.78 | 21.91 | 14.55 | 11.55 | 12.50 | 11.98 | |
| 8 | 17.82 | 61.85 | 117.79 | 14.17 | 16.00 | 11.23 | 9.43 | 11.69 | 11.59 | |
| 9 | 21.17 | 67.08 | 145.90 | 21.94 | 23.02 | 13.91 | 10.71 | 12.65 | 11.87 | |
| 10 (ultra-small) | 28.74 | 77.66 | 161.86 | 21.65 | 21.79 | 13.28 | 9.98 | 13.86 | 13.58 | |
| CRSP 10 minus 1 | 24.22 | 60.53 | 105.14 | 3.30 | 4.10 | -1.29 | -0.43 | 5.60 | 3.89 | |



Source: Compustate, Bridgeway

As always, thank you for your continued trust and confidence.

Warm regards,

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