

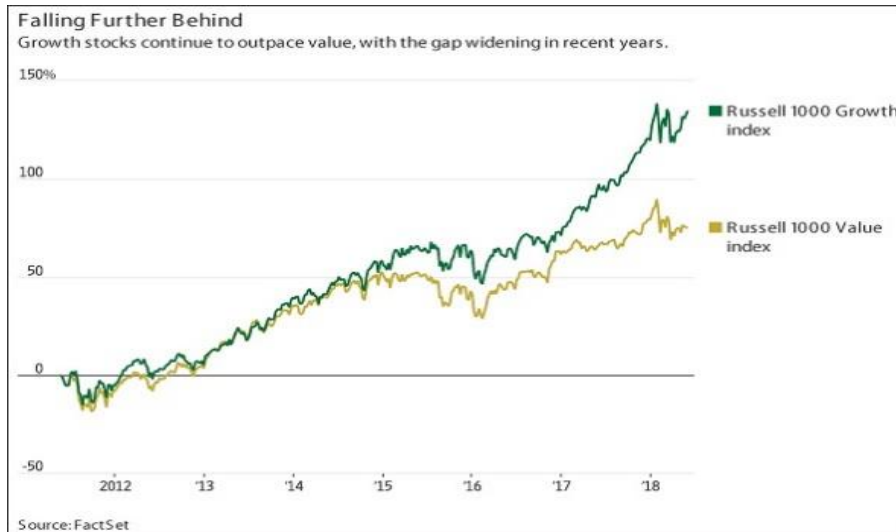
Don't Give Up on Value Investing

One of the tenets of prudent portfolio management is diversification. This concept is important because it is the cornerstone of risk management. Sometimes it is difficult to stay diversified when one strategy comes to dominate the stock market as growth investing is today.

It is wise to put some perspective on this phenomenon. **First of all, value investing has one of the best track records over the very long term.** During the current bull market growth investing had moderately outperformed since the financial crisis until value investing came back into favor in 2016 gaining 10% more than growth. Value's time in the spotlight was short lived as growth has come roaring back. Since the beginning of 2017 growth has outperformed value by an astonishing 28%!

- Growth Stocks- Faster growth more expensive valuation.
- Value Stocks- Moderate growth, attractive valuations & financials

This kind of lopsided performance should raise red flags. Late in an economic cycle investors often gravitate to growth companies regardless of valuation. In the late 1960s, investors believed the Nifty Fifty stocks had something like foolproof business models that were impervious to the economic cycle. However, as the economy suffered in the 1970s, these stocks tanked far worse than the stock market as a whole. Same thing happened during the Tech bubble at the turn of the century. And while growth stocks as a group are not near the level of overvaluation as the dotcoms in the 1990s they are universally loved and not cheap.



There are two true but contradictory facts about the stock market –short term momentum and long term reversal. When short term momentum is in control growth stocks outperform. When long term reversal kicks in value stocks become the leaders. While we still own some growth companies we have been trimming these winners and adding to value stocks because we believe the transition from short term momentum to long term reversal is becoming more likely.

Jim Tillar, CFA and Steve Wenstrup

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OUTSIDE COMMENTARY

Wall Street Journal - June 4, 2016

Existential Crisis: Value Investors- (excerpt)

Perhaps one of the more controversial changes among value investors is the drift toward growth companies. Value investors who justify buying shares of Amazon.com Inc. or Netflix, for example, say it is because those companies are still undervalued by the broader market, despite their big revenue growth. Others call it portfolio window-dressing to boost returns.

Eddie Perkin, chief equity investment officer at Eaton Vance, said value funds that have ignored the hugely popular FANG stocks— Facebook Inc., Amazon, Netflix and Google parent Alphabet Inc. — run the risk of being left behind in the market.

“The FANG stocks are so dominant in those benchmarks that to not own them, you got really hurt the last few years,” he said. So you had to have those in your portfolio to keep up with other growth managers.”

Eaton Vance's Large-Cap Value Fund, which has been in existence for more than 80 years, is tilted toward financial stocks such as JPMorgan Chase & Co. but also counts a position in Alphabet.

Even longtime value investors like Mr. Buffett eventually gave in to the changing value landscape, though his timing hasn't been ideal. His conglomerate Berkshire Hathaway first took a position in Apple in early 2016, after the stock was already expensive by some measures, and has steadily increased its stake since then.

Rather than embracing the popular tech stocks, Richard Mathieson, portfolio manager of the BlackRock Advantage Large Cap Value fund, tracks fund flows and other positions to identify crowded positions and find companies that may have been left behind. The fund invested in semiconductors, a corner of the technology market that isn't a traditional value play but more investors say is becoming attractive due to growing demand for chips.

“Traditional value styles of buying cheap stocks has been in the doldrums for a long time,” Mr. Mathieson said. “Our approach to value has evolved.”

The BlackRock fund is down 0.7% this year, after posting a 15% return in 2017, its best gain over a 12-month period in four years.