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The Value Factor

What is Value?

Value is the simple premise that less expensive investments may outperform more expensive ones over time. Although much work was done prior, the Value factor is largely attributed to the work of Eugene Fama and Ken French. Their 1992 paper is titled "The Cross Section of Expected Stock Returns".

How is it captured?

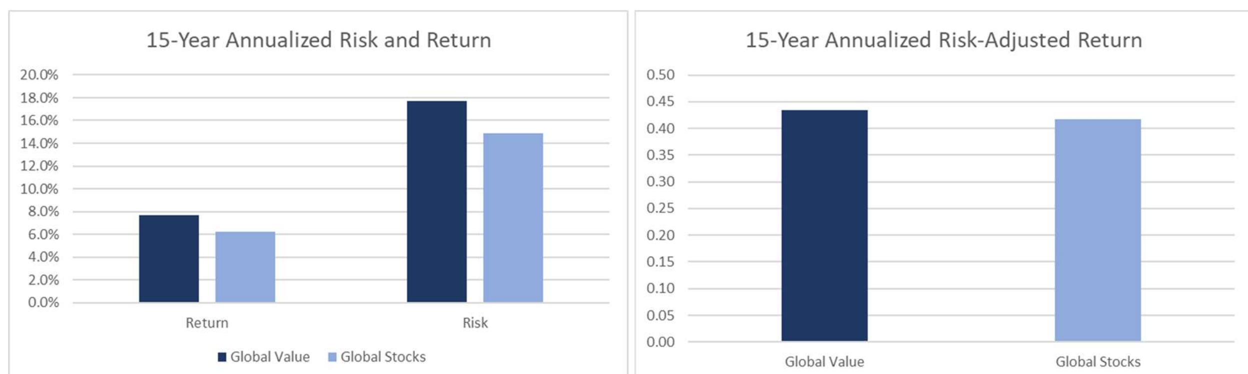
The most well-known metric to capture the Value factor is likely the price-to-earnings ratio. However, there are others like price-to-book, price-to-sales, and so on. Many factor indexes (and the Exchange Traded Funds, or ETFs, that track them) will use more than one metric.

Why does it work?

The most common explanation for the efficacy of the Value factor (why it generates an excess return) is that the expected return for any security is determined by its valuation. Furthermore, depending on the metric(s) used to find them, value stocks may be riskier than the market or growth stocks and therefore they are rewarded with a premium return.

How has it worked?

Through December 31, 2018, Value (as measured by the MSCI ACWI Enhanced Value Index) has outperformed the market (as measured by the MSCI All Country World Index) on both an absolute and risk-adjusted basis.



Source: Morningstar

How do we use it in a portfolio?

Metric portfolios currently gain exposure to the Value factor in equities by investing in ETFs that track the MSCI USA and World Ex USA Enhanced Value indexes. Both indexes are constructed based on 3 metrics: price-to-book, price-to-forward earnings, and enterprise value-to-cash flow from operations. A key benefit of including Value in a portfolio, aside from its potential for excess return, is its diversifying impact on other factors, particularly Momentum.

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