

Ready, steady,
rotate

It is a matter of style: Ready, set, rotate

What is it?

We believe Value will outperform Growth and Quality as the recovery broadens beyond COVID-19 beneficiaries over a 12-month horizon.

Why now?

Value style (stocks offering inexpensive valuations on traditional metrics) has experienced one of the worst decades of underperformance relative to the Growth style (stocks with high current and future expected growth). However, prospects of stronger global economic and earnings growth thanks to positive vaccine developments, cheap valuations and light investor positioning suggest this style could continue to catch up with Growth and the broader markets.

Investment implications: Historically, Value stocks have tended to outperform during strong economic recovery. Investors can consider raising their exposure to Value equities, with a slight preference over the Growth and Quality styles within a diversified allocation.

Risks: Potential disruptions in the distribution of vaccines, lower than expected bond yields are key risks to our constructive view on the Value style.



DOES THE NEW DECADE USHER IN A TURNING POINT FOR VALUE VERSUS GROWTH?



BULLISH
on risky assets in 2021

Our latest analysis on factor-based investing, in combination with the results of the US election, lead us to conclude that as the recovery broadens beyond Growth equities and the key beneficiaries of the COVID-19-induced shutdowns, laggards and Value-oriented sectors are likely to see further gains. Historically, Value stocks have tended to outperform during the early phases of past economic recoveries. We believe Value will outperform Growth on a 12-month horizon, with gains likely front-loaded in 2021. Investors can therefore consider increasing exposure to Value style equities, with a slight tilt over Growth within a diversified allocation.

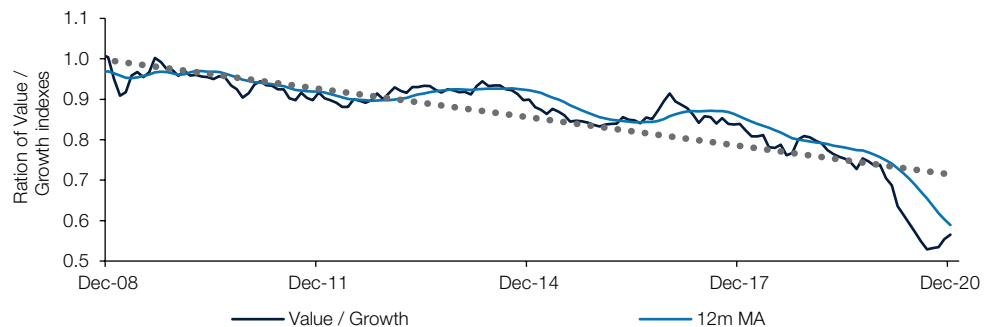
The above conclusions rest on our view that a post-COVID world is likely to be bullish for risky assets in 2021. An end to 'man-made' restrictions on economic activity raise the prospect of a return to pre-COVID activity levels once a vaccine is widely available. Continued ultra-supportive monetary and fiscal policy should help accelerate this process.

Look beyond the US election implications for drivers of Value vs. Growth performance

The US elections have ignited interest surrounding portfolio rotations due to the different policy stances of the two candidates and their implications on financial assets (see case study on page 5). However, we observe a confluence of factors, such as the performance and valuation gap, investor positioning and flows, sector and country breakdowns, are also key to this debate. We explore these factors in detail in the following pages to determine whether the recent Value outperformance warrants a long-term shift in investors' portfolios or rather, is just a short-lived catch-up rally.

Global Value versus Growth: inching toward the 12-month moving average as vaccine news boosts cyclical sectors

Ratio of Global Value and Growth total return indices



Source: Datastream, Standard Chartered
Dotted line indicates the linear trend for the select period



-30%

Value's performance has lagged Growth even more significantly in 2020

Performance vs. valuations

Since the official end of the Global Financial Crisis (GFC) in May 2009, Growth has outperformed Value by a factor of ~2.1x globally; that is an average outperformance of ~5.3% annually. In 2020, Value's performance has lagged Growth even more significantly (-30%), a magnitude several times larger than the average volatility of these two indices during the post-crisis period. If Value's performance were to simply revert to the recent trend, it would outperform Growth in 2021. However, we note that during this period Value rallies have only lasted 2-3 months at a time on average. Therefore, while long-term drivers of outperformance continue to shift in favour of Value (as we will see later) this recently observed behaviour of short bursts of outperformance leads us to believe that gains in 2021 may be front-loaded.

Valuations also point to extreme divergence between these two styles. In fact, based on various valuation metrics, Value equities look extremely cheap versus Growth (in the bottom 5% percentile since the GFC). We note, however, that valuations alone have historically not been a reliable mean-reversion indicator for equities over short time periods.

Fund flows and positioning

In the past few months, investor sentiment on the Value style has turned rather constructive, with a growing number of investment managers favouring Value strategies.

For institutional investors, however, this has been a difficult view to implement for several reasons: 1) FAANGM's weight in benchmarks; 2) range-bound US Treasury yields; and 3) likely a predisposition towards holding on to year-to-date winners until the close of the calendar year.

An analysis of global active mutual funds and ETF flows reveals that only a fraction of outflows (~20%, based on Lipper data) have returned back into Value equities since their most recent nominal high H1 2018. Hence, despite the current strong rally, Value equities are still broadly under-owned compared to Growth, in our assessment, particularly in the US.

Sectors breakdown

We expect Value-oriented sectors to benefit from fiscal and monetary policies in major economies as they remain very supportive. This policy stance will likely help the global economy tide over the early part of 2021 before widespread vaccination allows economic activity to accelerate.

At present, the largest sectors within the Value universe for global equities are Financials, Healthcare and Industrials, while for the Growth index the largest sectors are Technology, Consumer Discretionary and Healthcare. Hence, for Value to outperform Growth in 2021, Financials and Industrials will likely have to outperform Tech and Consumer Discretionary (although this would not be the only path to outperformance).

Sector breakdown of the global Value and Growth indices versus Global Equities

MSCI World index sector and styles breakdowns (weights in %)

| Sector | Value | Growth | MSCI World |
|-------------------------------|-------------|-------------|------------|
| Technology | 7.5 | 33.8 | 21.6 |
| Healthcare | 12.2 | 14.6 | 13.5 |
| Consumer Discretionary | 8.3 | 15.0 | 11.9 |
| Consumer Staples | 9.6 | 6.9 | 8.1 |
| Communication Services | 7.1 | 11.0 | 9.2 |
| Financials | 21.6 | 3.9 | 12.1 |
| Industrials | 12.4 | 8.8 | 10.4 |
| Materials | 5.6 | 3.6 | 4.5 |
| Energy | 4.9 | 0.3 | 2.4 |
| Utilities | 6.9 | 0.4 | 3.4 |
| Real Estate | 3.9 | 1.8 | 2.8 |

Source: MSCI, Standard Chartered as of 31-Oct-2020, weights may not add up to 100% due to rounding

WHAT ARE THE SIGNPOSTS TO WATCH FOR VALUE'S OUTPERFORMANCE TO EXTEND?

While the above factors are likely catalysts for a continuation of the recent rally into 2021, we suggest monitoring the following economic signposts as they typically constitute Value's long-term fundamental drivers:



Sustained improvement in economic growth:

Value needs elevated (typically above 3%) or rapidly increasing rates of US economic growth to outperform Growth. Recent GDP forecast revisions have improved, helped by the ongoing recovery as indicated by recent regional business surveys. Although, the increase in COVID-19 infections, particularly in Developed Markets, may lead to some softness in Q4 2020 data, we expect the rollout of widespread vaccination programmes to accelerate economic activity in 2021.



Rebound in inflation expectations:

Despite the recent positive vaccine news, inflation expectations have only rebounded back to the 10-year average (1.93%). Recent data shows that Value sectors (such as Financials and Energy) have become more tightly correlated with inflation expectations in the past 5 years. A continued rebound in inflation will be key to support the outperformance of these sectors and Value versus Growth. Looking at 2021, recent studies point to the currently high consumer savings rates in major economies (i.e. an indication of pent-up demand) and the unprecedented amount of liquidity from easy monetary policy as two potential precursors of higher inflation.



Rising bond yields:

The secular decline in bond yields has boosted the valuations of longer-duration Growth companies (as they typically derive a large part of their cashflows in the distant future), hence an increase in yields would likely reverse this trend. History shows that government benchmark rates typically follow economic growth higher. However, the Fed and other Central Banks look set to keep these capped in the coming years. Investors should focus on any changes in the messaging from major central banks around the future path of monetary policy and the impact on interest rates from Quantitative Easing programmes.

In conclusion, shorter-term market-based catalysts will act as tailwind for Value sector and regions to outperform Growth in 2021 with a fair chance for returns to be frontloaded. We don't believe Growth will perform poorly. However, given its extraordinary post-financial crisis performance versus Value, investors could benefit from scaling back some exposure and allocating it to Value-oriented global equities for the next 12 months.

CASE STUDY

Policy implications from the US election

At the time of writing, President-elect Joe Biden looks set to cement his presidential election victory over incumbent Donald Trump. However, this could be accompanied by a divided Congress.



The fight for the Senate will be decided by the Georgia special election run-offs on the 5th of January. Republicans have already sealed 50 seats this election, while Democrats hope to win the remaining two Georgia races to obtain a tie in the Upper House of Congress. In case of an evenly split Senate, the sitting Vice President marks the tie-breaking vote, hence giving Democrats a slight edge in passing upcoming key policies.


Our base case is one of a divided Congress. Under this scenario, some of Biden's key policy proposals may be scaled back, in order to win over Republicans' approval. For example, the proposed USD 2 trillion green infrastructure spending plan, doubling the minimum wage and expanding 'Obamacare' are

amongst the many that may be amended (see table on page 6 for more). On the other hand, less market-friendly policies such as the proposed rise in taxes and greater regulation against old-energy, technology and pharmaceuticals sectors may also be revised down in order to pass both Houses of Congress.

On the foreign policy front, President-elect Biden will have more room to manoeuvre thanks to the use of Executive Orders. Although the attitude towards China has grown increasingly negative across both Parties and the American public (as per recent surveys by the Pew Research Center), we foresee a much more diplomatic approach going forward. Market adjustments, therefore, may return to being more gradual rather than sudden, and sharper in nature.

MARGINAL DEMOCRAT WIN[^]

| | |
|------------------|--|
| PRESIDENT | JOE BIDEN |
| HOUSE AND SENATE | D&D* (WITH NARROW SENATE MAJORITY) OR D&R* |

|  POLICY IMPLICATIONS | |
|--|--|
| Corporate taxes | Democrats to scale back corporate tax hike agenda |
| Personal taxes | Odds of Trump tax cuts expiring in 2025 rise; minimum wages likely to rise by a lesser extent vs the proposed USD 15/hr |
| Healthcare | Lower drug prices, given it has bipartisan support; expansion of Obamacare less likely |
| Fiscal policy | Less than USD 2 trillion in pandemic stimulus; toned-down green infrastructure spending and cleaner tech regulations; re-enter Paris climate pact; lower chance of policies against fossil fuels |
| Regulatory policies | Fewer regulatory changes; rely more on executive orders |
| Foreign policy | Continuation of tough stance on China, with a more diplomatic approach; re-entering TPP unlikely |
| Legislation | Delays in Senate legislations as Republicans take on filibustering |

Source: Standard Chartered

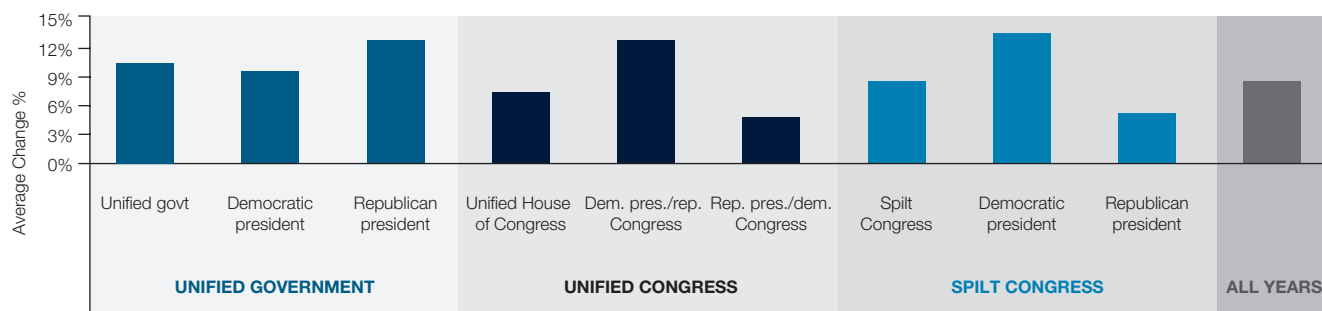
Note: [^] Marginal Democrat win = Biden as president, small Democrat majority in Senate and/or House; * D = Democrat, R = Republican

‘OUTSIDE VIEW’ - THE HISTORICAL PICTURE

Historically, in the year after a presidential election, US stocks have returned c. 10% on average. We also note that, Asia and Emerging Market equities tend to post strong positive performance accompanied by elevated hit rates*. High Yield and Emerging Market bonds have outperformed their government or investment grade peers on average as well.

The Georgia Senate run-off elections in 2021 will be key to determine the final composition of the US Senate

S&P500 average annual returns under various election outcomes



Source: Bloomberg, Standard Chartered

US stocks and High Yield and Emerging Market bonds have provided strong returns in the first year after an election

Average and median asset class returns in the first year after an election

| Level 1 | Average Return | Median Return | Hit Rate* |
|---------------|----------------|---------------|-----------|
| Bonds | 3.9% | 3.0% | 77% |
| Equities | 10.2% | 12.7% | 75% |
| Gold | 13.8% | 15.0% | 72% |
| Alternatives | 5.0% | 5.2% | 93% |
| Equity | | | |
| US | 9.9% | 13.4% | 78% |
| EU | 9.5% | 5.2% | 65% |
| UK | 10.3% | 9.9% | 72% |
| JP | 7.2% | 8.4% | 67% |
| AxJ | 17.8% | 16.6% | 87% |
| EM x Asia | 16.5% | 9.9% | 60% |
| Equity | | | |
| DM Govt Bond | 3.2% | 3.6% | 73% |
| DM Corp Bond | 5.9% | 5.6% | 85% |
| DM HY | 13.5% | 9.4% | 90% |
| EM USD | 9.0% | 9.2% | 75% |
| EM Local | 6.5% | 6.3% | 68% |
| Asia HC | 8.1% | 7.6% | 93% |

Source: Bloomberg, Standard Chartered

*Hit rate shows the percent of 1-year periods after an election when the returns were positive

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