

Value vs. Glamour Revisited: Historical P/B Ratio Disparities and Subsequent Value Stock Outperformance in Non-U.S. Markets

Recently, the Brandes Institute revisited its Value vs. Glamour research, focusing on two aspects:

1. The valuation difference in price-to-book (P/B) ratios between decile 10 stocks (value) and decile 1 stocks (glamour)
2. The relationship between that difference and subsequent relative performance

Extending our research to *non-U.S.* stocks, Exhibit 1 shows the median P/B ratios for value and glamour stocks were 0.16 and 1.66, respectively, as of September 30, 2009.

EXHIBIT 1: UNIVERSE, DECILE 10, AND DECILE 1 CHARACTERISTICS

	Universe	Value Stocks (Decile 10)	Glamour Stocks (Decile 1)
Number of Securities	3,158	315	315
Median P/B Ratio	0.69	0.16	1.66
Avg. Market Cap. (millions)	\$5,726	\$2,014	\$7,407

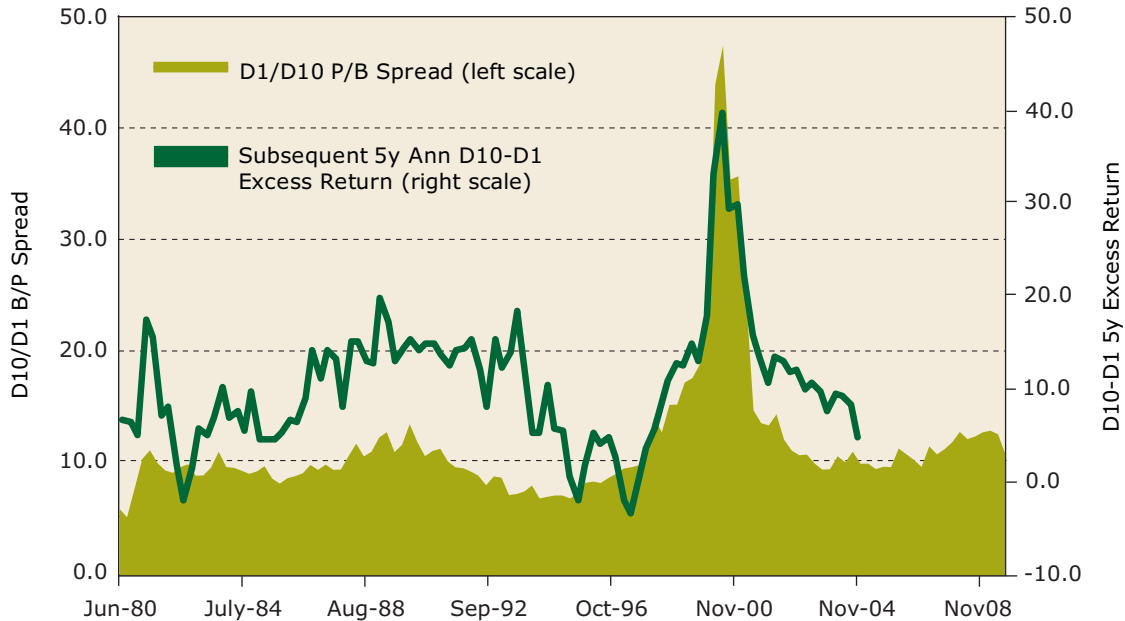
Source: Worldscope via FactSet; the Brandes Institute, as of 9/30/09

We measured the difference in value and glamour valuations for non-U.S. stocks using a P/B multiple derived by dividing the decile 1 P/B ratio by the decile 10 P/B ratio. As shown in Exhibit 2, historically, when this multiple peaked (left scale), value stocks delivered meaningful outperformance over the subsequent 5-year period (right scale). At the extreme, the multiple expanded to 47.3 in March 2000. In other words, during this period of inflated share prices, non-U.S. glamour stocks were nearly 50 times more expensive than value. From that point in 2000, decile 10 stocks outperformed decile 1 stocks by 39.3% annualized over the next five years.

The most recent 5-year period (through 9/30/09) shows value stock outperformance of 4.2% annualized. Earlier this year, the multiple climbed to nearly 13.0. It fell to 10.1 on September 30, 2009, very close to the median multiple of 10.0 between 1980 and 2009. Over the history of our study, value stocks' median *outperformance* was 9.9%. While past performance is not a guarantee of future results, we think an understanding of market history can be instructive. And we believe the current gap between median P/B ratios for non-U.S. value and glamour stocks suggests favorable opportunities may exist for value investors over the next five years.

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EXHIBIT 2: VALUE VS. GLAMOUR P/B MULTIPLE FOR NON-U.S. STOCKS AND SUBSEQUENT 5-YEAR ANNUALIZED EXCESS RETURNS



Source: Worldscope via FactSet; the Brandes Institute, as of 9/30/09. Past performance is not a guarantee of future results.

METHODOLOGY RECAP

The universe of stocks for this study consists of a market capitalization-constrained subset of all companies domiciled outside the United States in the Worldscope database. Starting with all developed, non-U.S.-based securities in the Worldscope database, we excluded the smallest 50% of companies based on market capitalization. The Worldscope database includes companies with market capitalizations ranging from hundreds of billions of dollars (USD) to less than \$1 million. The removal of micro caps, or firms with prohibitively small market capitalizations, yielded a sample that more accurately represented a truly “investable” universe in our opinion.

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Next, we followed the approach outlined by academics Josef Lakonishok, Andrei Shleifer, and Robert Vishny (collectively, “LSV”), as described in their article, “Contrarian Investment, Extrapolation, and Risk.”¹ LSV’s methodology can be condensed into three basic steps:

1. The sample of companies, starting June 30, 1980, was divided into deciles based on various valuation measures, such as P/B ratio.
2. The aggregate performance of each decile was tracked for each of the next five years on each June 30.
3. The first and second steps were repeated for each June 30 from 1980 through 2004.

VALUE VS. GLAMOUR SUMMARY

As described in greater detail in our study, “Value vs. Glamour: A Global Phenomenon,” the Brandes Institute has identified a persistent value premium for the world’s developed markets in aggregate and on an individual country basis. A value premium was evident or probable for the markets that offered enough robust data to provide reasonable conclusions. In short, value stocks consistently outperformed glamour stocks during our study period – 1980 to 2008.

¹Lakonishok, Josef, Andrei Shleifer, and Robert Vishny. 1994. “Contrarian Investment, Extrapolation, and Risk.” *Journal of Finance* 49 (December): page 1541-1578.

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