Value vs. Glamour Revisited: Historical P/B Ratio Disparities and Subsequent Value Stock Outperformance

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

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

As shown in Exhibit 1, the median P/B ratios for value and glamour stocks were 0.50 and 7.69, respectively, as of April 30, 2009.

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

	Universe	Value Stocks (Decile 10)	Glamour Stocks (Decile 1)
Number of Securities	2,674	267	267
Median P/B Ratio	1.53	0.50	7.69
Avg. Market Cap. (millions)	$3,799	$1,086	$6,884

Source: Compustat via FactSet; the Brandes Institute, as of 4/30/09

We measured the difference in value and glamour stock valuations 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 81.1 in February 2000. In other words, during this period of inflated share prices, glamour stocks were 80 times more expensive than value. From that point in 2000, decile 10 stocks outperformed decile 1 stocks by 50.6% annualized over the next five years. More recently, the multiple climbed above 20.0 in February 2009 for the first time since January 2001; it was 15.4 on April 30, 2009. Between 1968 and 2008, the average multiple was 12.3; the median multiple was 11.1.

While past performance is not a guarantee of future results, we think an understanding of market history can be instructive. We believe the current expansion in the gap between median P/B ratios for value and glamour stocks suggests value stocks may be poised to meaningfully outperform glamour over the next five years.

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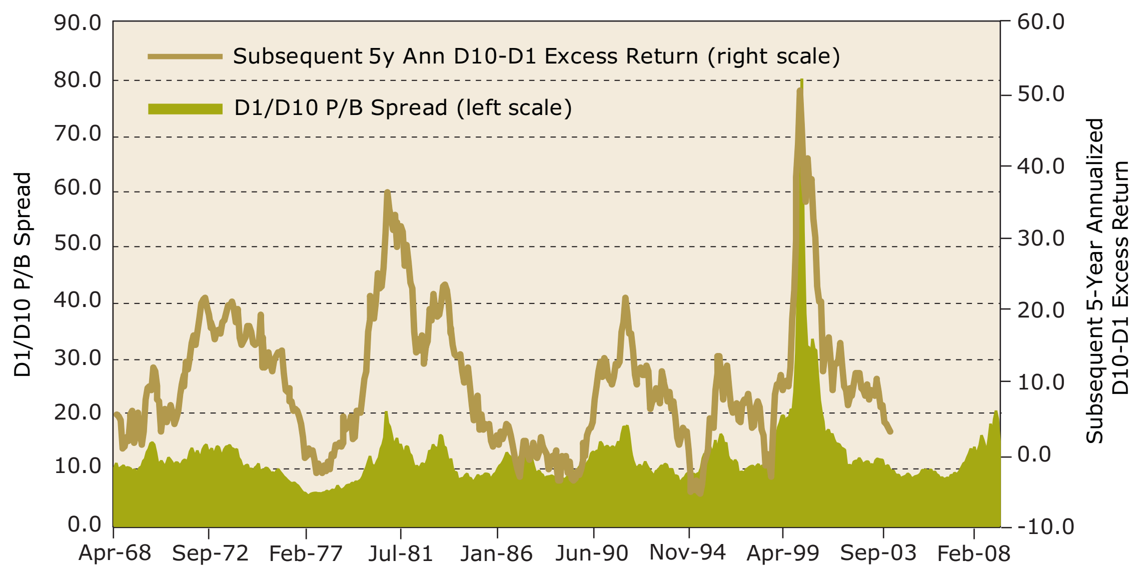
EXHIBIT 2: VALUE VS. GLAMOUR P/B MULTIPLE AND SUBSEQUENT 5-YEAR ANNUALIZED EXCESS RETURNS



Source: Compustat via FactSet; the Brandes Institute, as of 4/30/09

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 in the United States in the Compustat database. Starting with all U.S.-based Compustat constituents, we excluded the smallest 50% of companies based on market capitalization. The Compustat database includes U.S. companies with market capitalizations ranging from hundreds of billions of dollars 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 April 30, 1968, 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 April 30.
3. The first and second steps were repeated for each April 30 from 1969 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 – 1968 to 2008.

[1] Lakonishok, Josef and Andrei Shleifer and Robert Vishny. "Contrarian Investment, Extrapolation, and Risk." *Journal of Finance* 49 (December): pages 1541-1578.

11988 El Camino Real
Suite 500
P.O. Box 919048
San Diego, CA 92191-9048
858.755.0239
800.237.7119
Fax 858.755.0916
brandesinstitute@brandes.com
www.brandes.com/institute

0609