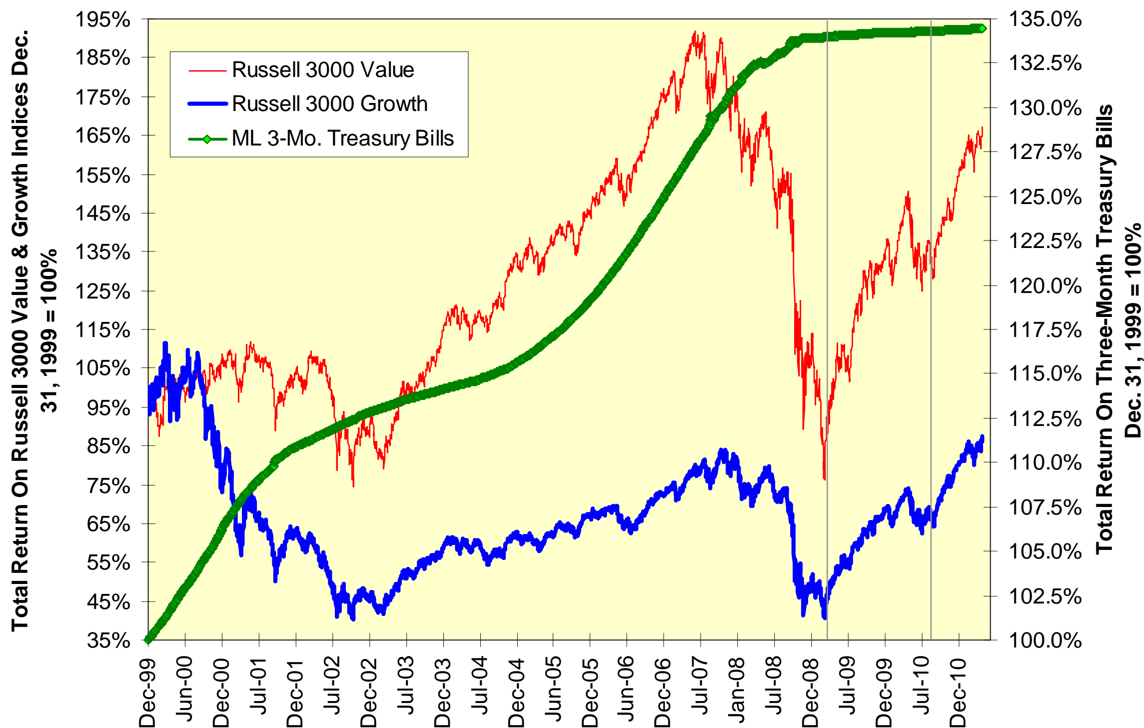
Growth And Value In The QE Era

Just as the Great War did not get renamed World War I until a second World War was underway, we did not name the first round of quantitative easing beginning in March 2009 with a number. In an eerie parallel to discussions during World War II as to when World War III would begin – the assumption everywhere was there would be a WW III – we are discussing when and under what conditions QE III will arrive or if the announced intentions to reinvest the proceeds from the Federal Reserve's portfolio will constitute QE 2.5.

Growth And Value

Let's map the total return streams for the Russell 3000 Value and Growth indices and for three-month Treasury bills, all indexed to that long-ago Y2K day of December 31, 1999. Two dates are marked, the initiation of QE1 on March 18, 2009 and Bernanke's Jackson Hole speech on August 27, 2010. As an aside, I have found myself using "Jackson Hole" more as a date than as a place over the past eight months. Also, these indices support ETFs (IWW and IWZ for the Value and Growth indices, separately).

Comparative Total Returns

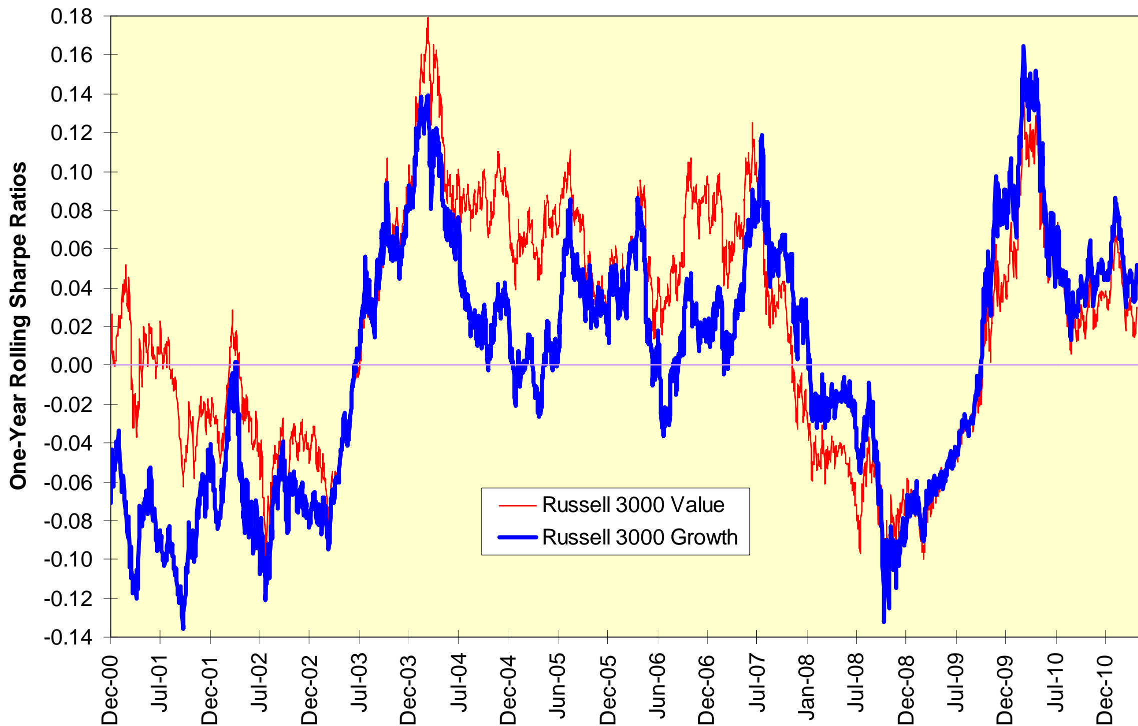


If we measure period total returns from QE1, the Growth index has outperformed the Value index handily, 35.9% to 30.2%. However, if we switch the starting date to Jackson Hole, the average annual rates are much closer to one another, 29.9% to 28.1%. If we account for the comparative standard deviations of returns, which we must, the two styles' total returns over the whole QE era are equivalent at a 96.3% confidence level.

The question, "How much risk did you take?" tends to arise more during bear than during bull markets, which perhaps explains why this last little statistical point may be surprising to many.

The Sharper Image

As long as we are on the subject of risk and return, let's compare the one-year rolling Sharpe ratios for the two styles; this is the excess return for the indices divided by their standard deviation of returns. As a benchmark, anything over 1.00 for an alternative investment manager is considered good; a Sharpe over 2.00 gets asset allocators on a plane to come and seen you.



As you can see, the Sharpe ratios here are surprisingly low for the combination of being in a bull market and having a very low hurdle in the risk-free rate. The QE-era Sharpe ratios peaked in March 2010 and have drifted lower. It may be hard to remember now that we are in May 2011, but May 2010 was the worst May since 1940, a time when the British Expeditionary Force was evacuating at Dunkirk.

Chasing Returns

Finally, if we are in a low-growth environment as Ben Bernanke says and if rates are being kept artificially low, then you might expect value issues to be favored over growth by virtue of their higher expected dividend yields, 2.19% versus 1.33%. It has not worked that way: Risk-preference has been the hallmark of the QE era, both in bonds as well as in stocks and certainly in almost all other asset classes. The elimination of safe investment vehicles, as witnessed by those low Treasury bill returns, has forced investors into a higher-risk profile. It is working now; if and when the game ever ends, a new strategy will be indicated.