HILLCREST ASSET MANAGEMENT

Thoughts on the Opportunity in Value Investing

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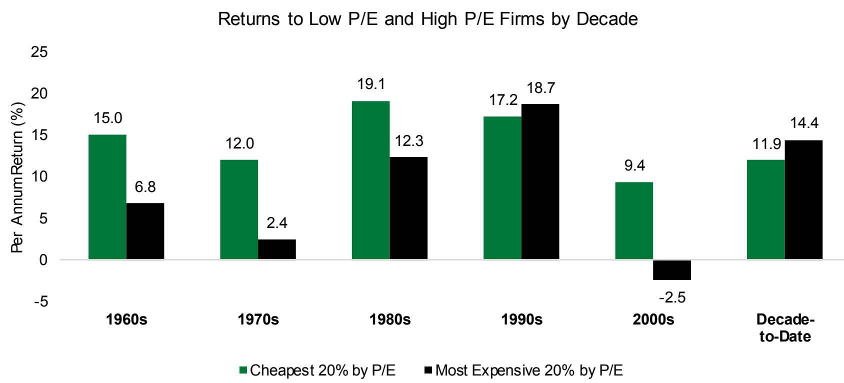
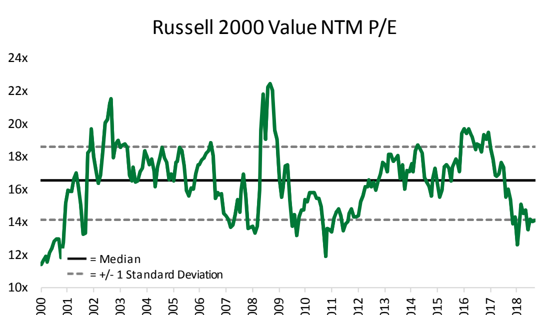
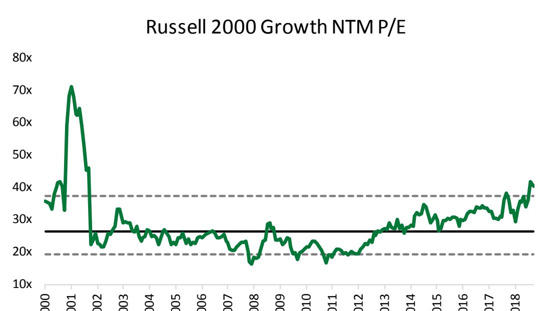
A widely publicized characteristic of the recent market environment has been the challenges faced by valuation-focused equity styles and strategies relative to higher growth counterparts. The seemingly prolonged nature of these relative headwinds has caused some to doubt the fundamental efficacy of value equities as the recent underperformance of the style is increasingly accepted as the status quo. However, we would urge investors not to fall victim to the recency bias that would suggest that something will not work in the future just because it has failed to do so in the periods that are easiest to recollect. To illustrate the benefits of maintaining an appropriately wide frame of reference rather than an undue focus on recent periods, the chart below exhibits the returns that value equities have generated relative to more expensive peers over time.



Data source: Kenneth French Data Library.
Calculations performed by Hillcrest Asset Management. Decade-to-Date includes period through 06/2019.

Despite what recent periods would suggest, the data above shows that value equities have generated robust returns relative to more expensive growth-oriented equities over the long-term. Of course, some would argue that this historical data has no bearing on the future, given that we have purportedly entered a new paradigm. However, this view is unfounded and myopic. We believe it is imperative to understand that the view that value-focused investment frameworks will be upended by a new paradigm is one that has never come to fruition despite being routinely propagated over time. In particular, there were periods in each decade above where the notion that value equities would no longer work became the prevailing thesis, such as the "'Tronics" Boom of the 1960s, the Nifty Fifty stocks of the 1970s, the Biotech Bubble of the 1980s, or the Dot-Com Mania of the 1990s, though in each case "this time" did not prove different. Thus, while value equities have faced headwinds in the recent environment, decades of data evidence that this phenomenon is an aberration rather than the status quo.





Source: Hillcrest Asset Management. All data is pulled from Factset on a monthly basis and runs from 10/31/2000 – 09/09/2019.

With that said, we still see pockets of attractively valued securities in the broader market and believe that small capitalization value equities are the most attractive domestic allocation opportunity. This can be seen when considering that the Russell 2000 Value is currently trading at a one standard deviation discount to its long-term P/E valuations, a level that has only been reached a handful of times in nearly twenty years. The attractiveness of small cap value equities is juxtaposed against the frothy valuations of many other domestic equity styles, with growth-focused styles trading at a particularly meaningful premium to historical P/E valuations. We believe these valuation disconnects are unsustainable and have created a strongly supportive set-up for the forward returns of small capitalization value equities.

About Hillcrest Asset Management

Hillcrest Asset Management is an institutional investment management firm and a recognized leader in the field of Behavioral Finance investing. Our investment philosophy and process are guided by a fundamental belief that stocks deviate from their fair value due to investor behavioral biases. Hillcrest's experienced investment team believes that stocks follow the behavioral cycle of stock movements. We combine model-driven behavioral analysis with traditional fundamental research to build on the strengths of both approaches.

Hillcrest was founded in October 2007 and has offices in Dallas and Boston.

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